Improving the Integrity of the Global Supply Chain: Working with Compliant Business Partners

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Abstract

International trade forms the backbone of many countries’ economies. Certain commodities cannot be freely traded without demanding controls and legal obligations being fulfilled. In this context, industry seeks to ensure that their trade partners comply with applicable international laws and regulations. Concurrently, governments have limited resources for border enforcement and need to use risk assessment methods to identify where they should focus their efforts. This paper will analyse existing secured supply chain programmes, standards and good practice guides and the collective effectiveness of the different programmes.

Introduction

All goods must be transported somewhere at some point. While most commodities are harmless, in many cases restrictions exist on who can receive them. Certain other commodities such as conventional weapons and Weapons of Mass Destruction (WMD)-related items have considerable control elements put in place by regulatory authorities of countries that prohibit export without licences or even at all. Commodities that have both civilian and military uses are handled by regulatory authorities as ‘dual-use’.

In order to help businesses comply with complex requirements with the ultimate goal of safe and secure trade, governments as well as industry have created numerous compliance programmes, standards and good practice guides. These are of vital importance in assisting in securing of the global supply chain. The ‘supply chain’ is often interpreted differently in different industries. In the context of this paper, ‘supply chain’ is referred to as an international transaction involving multiple companies, transport

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2 EU definition of Dual-use items: “Dual-use items are goods, software and technology normally used for civilian purposes but which may have military applications, or may contribute to the proliferation of Weapons of Mass Destruction (WMD).” European Council (EC) Regulation 429/2009, https://www.crowell.com/PDF/Council-Regulation-EC-No-4282009.pdf.
providers, governments, control regimes and countries. Compliance programmes and standards are internal policies and procedures developed by a company in order to meet the standards set by government laws and regulations. They have grown in importance as the regulations for many businesses and commodities have developed over time.

The pressure on companies to achieve accreditation in these different programmes and standards has created duplication and even triplication of compliance requirements in many cases. This paper aims to raise awareness of the potential of these different programmes, even if they may have the same core elements, to lead to confusion within businesses and the employees working with different programmes and possibly even a weakening of compliance standards as a result.

The paper will first present the background and rationale for compliance programmes and their implementation. It will also pinpoint areas where a lack of domestic and international visibility to governments and business alike may reduce their effectiveness. The paper will conclude by demonstrating that certain standardisation of programmes and their effective mutual recognition could greatly improve compliance and thereby the security of the global supply chain.

**Background**

In general, businesses seek to comply with the law and do the right thing. However, the multi-layered and multi-departmental approach to controls can make compliance complex and difficult to understand and implement. Ultimately this could potentially impact the overall compliance of a business as the risk of errors increases due to the duplication of compliance requirements.

Businesses invest considerable amounts of money every year to ensure that they have processes and procedures in place to comply with the myriad of international trade compliance regulations and laws that exist globally whilst also safeguarding employees, shareholders and customers. These organisations will then pass their compliant commodities to third parties in the supply chain and ultimately the end user or customer without any simple method of recognising how compliant these third parties or customers are.

To maintain the integrity of compliance standards a company has achieved, it is advisable to work with third parties and customers that operate with the same high compliance standards and accreditations. Failure to do so introduces potential compliance risk to the security of the overall supply chain. This can include unauthorised access to controlled commodities, diversion in transit, delivery to countries, organisations or individuals that may have active government sanctions in place. It could result in commodities that could be used to develop chemical weapons, dirty bombs, torture prisoners, monitor the public etc., falling into the hands of countries, organisations or individuals that cannot have legitimate access to them.

Due to the increasing awareness of the risk of WMD falling into the hands of malevolent state or non-state actors, the international community has seen a fast tracking of the introduction of secured supply chain programmes. Secured supply chain programmes, associations, alliances and trading standards have become a way of identifying individuals, organisations or groups that meet a certain criteria levels within a particular discipline that businesses are involved with.

The aim of the various secured supply chain programmes, good practice guides, and trading standards within various areas such as export controls, customs, and anti-corruption are, for example:

- Ensuring that controlled commodities are correctly exported and imported (Controlled commodities are items such as weapons, communication equipment, certain aerospace item etc., that may be required to have government approval via an export licencing process prior to export from a country);
• Ensuring that controlled commodities are not diverted to unintended recipients. (Controlled commodities can only be delivered to parties that are defined within the export licence and cannot be diverted to third parties without prior approval by the exporting authorities);
• Providing a secured supply chain from start to finish;
• Reducing the likelihood of illicit material travelling within the supply chain;
• Demonstrating that an organisation has at least minimum levels of security standards;
• Having clear and up-to-date policies and procedures;
• Providing regular staff training on compliance requirements;
• Having an internal and external escalation procedure (In the event of a discovery of a possible risk or non-compliant activity employees need to be very clear of who they should report the issue to both internally within the company and where necessary externally to the relevant regulatory authority.).

Secured supply chain programmes and standards will usually require the company to have been independently audited by accredited companies to validate that their internal processes and procedures meet the demands of the relevant programmes. The vast majority of these programmes and standards are voluntary and a great deal of the validation process is completed by the private sector. The relevant customs authorities usually validate customs secured supply chain programmes, however they also subcontract this process often to accredited third parties.

Many countries recognise the importance of having legislation in place to control exports from their countries and particularly the export of controlled commodities. The countries will have departments responsible for export controls, licencing and other related measures, however, they do not usually have recognised supply chain programmes that help identify compliant companies. Often the controlling governmental departments are known by different names in countries and may even have different reporting lines within the government. Countries usually provide ‘good practice’ guides and self-audit checklists that at least assist companies in developing internal standards.

Even with the existence of a recognised secured supply chain standard, the visibility of these programmes tends to disappear outside of the group of fellow participants and once the transaction becomes international there is no systematic method to support the identification of a compliant business partner. Considering the positive support from trade and the public it would be reasonable to believe that businesses, in general, and particularly ‘big business’, would be very compliant. Almost weekly news reports appear regarding organisations, companies (often Fortune 500) or individuals that have been penalised under one of the different legal regulations and standards that are required to be complied with to carry out business internationally. These regulations and standards cover a wide-ranging group of areas including export controls, anti-corruption, customs and more. In the example of the USA, these penalties can include financial penalties in the billions of dollars, penal servitude and loss of export privileges, as well as loss of business and reputation.

From a reputational point of view, the US has a very active ‘Name and Shame’ approach to companies that have either been found guilty of a violation or have reached a Deferred Prosecution Agreement (DPAs) with authorities. The US Bureau of Industry and Security (BIS) regularly publishes a substantial document entitled “Don’t Let this Happen to You” which lists in detail successful cases and DPAs that

5 A deferred prosecution agreement (DPA), which is very similar to a non-prosecution agreement (NPA), is a voluntary alternative to adjudication in which a prosecutor agrees to grant amnesty in exchange for the defendant agreeing to fulfil certain requirements.
have been actioned in the recent past. The Office of Foreign Asset Controls (OFAC) updates their website frequently with details of regulatory changes and organisations that have violated OFAC regulations. Many household names are included within the BIS publication and OFAC web updates.

The European Union has very similar and occasionally identical regulations and requirements in these areas. However, the implications for noncompliance in the EU are far less visible. There is no harmonized penalty structure for violations in these areas, and in the event of a prosecution, it is common for the withholding of company details to be part of the settlement. Each Member State of the European Union has a different penalty regime in place. In 2014 the Stockholm International Peace Research Institute (SIPRI) carried out research in this area. For various privacy related issues EU countries tend not to name offending companies but some countries do list on their web sites examples of recent successful actions. Occasionally details of criminal prosecutions for weapon trafficking or corrupt practises will air in the news, but such situations are the exception and tend to be high profile cases.

It is common that after violations occur (and in the USA often as part of the settlement), it is announced that the impacted company introduces a major internal compliance programme (ICP) review or audit and compliance initiatives. Often the cost of the ICP review will be considered part of the settlement. Most governments are keen to encourage companies to invest in ICPs to ensure that they achieve and maintain the necessary standards required to be a compliant company. The ICPs are often associated with a particular government and/or industry trade standard. An example of this would be the largest civil penalty BIS (USA) has ever levied against Weatherford International Ltd. and four of its subsidiaries who agreed, in November 2013, to enter into a deferred prosecution agreement and pay a combined $100 million for export control violations related to export of oil and gas equipment. Weatherford agreed, as part of the settlement agreement, to hire an unaffiliated third party expert in US export control laws to audit its compliance with respect to all exports and re-exports to Cuba, Iran, North Korea, Sudan and Syria for calendar years 2012, 2013 and 2014.

Compliance Programmes and Compliance Standards

The export of controlled commodities is an important source of revenue for many businesses and is therefore often a significant factor in the national economy of the countries they do business in. The SIPRI Military Expenditure Database for 2014 shows that global expenditure on military items reached $1767 billion in that year. Many countries and organisations offer guidance on compliance programmes and standards relating to the subject of export controls. The introduction to the United Nations

10 UK Department of Business, Innovation and Skills – Compound penalty cases, http://blogs.bis.gov.uk/exportcontrol/prosecution/compound-penalty-cases/.
Development Programmes ‘Internal Compliance Programmes’ guide provides some important direction on why these programmes and standards are important:

- “Governments recognise that it is in their interests to monitor exports of arms, military equipment and dual-use items, and that way ensure that they are not destined for undesirable end-users and end-uses while limiting the negative impact on trade.”
- “Governments, therefore, have to seek to enshrine an ‘export control culture’ among the relevant companies.”
- “An internal compliance system is an arrangement in which a company ensures that it is completing legal transactions, obeying the regulations enacted by the government, and fulfilling company export policies.”
- “Internal compliance systems typically include a set of procedures that company officials must satisfy before an item leaves the company.”
- “An ICP should consist of “operational export compliance policies and procedures and a written set of guidelines that captures those policies and procedures.”
- “Such processes help build trust between companies and government agencies.”

The point “such processes help build trust between companies and government agencies” is arguably the most important one in the list as it focuses on the need to build trust and to demonstrate that this trust continues to be warranted. However trust is subjective and needs to be substantiated. Just because a violation has not happened to date does not mean that a company has the correct process and procedures in place to ensure ongoing compliance.

Compliance programmes and standards have historically been developed in silos directly connected to a particular industry or risk. They are often initiated as a direct result of an incident that has occurred somewhere in the world. There is usually very little involvement of subject matter experts outside of the functional government department responsible or the major companies within the particular industry sector impacted. Cross governmental or cross industry implications are not usually considered when creating a new compliance programme or standard, thus leading to likely duplication of compliance activities and confusion in areas not directly involved in the original concept of the programme or standard.

These programmes and standards come in a variety of forms, from the Customs secured supply chain programmes such as the EU’s Authorised Economic Operator programme (AEO), the USA’s Customs-Trade Partnership Against Terrorism (C-TPAT) which was an import only programme until recently but is now being expanded to cover exports from the USA, Singapore’s Secured Trade Partnership (STP) and many more. Non-governmental organisations (NGOs) such as the International Standards Organisation (ISO) and their compliance related standards in areas such as risk management, information security and quality management, trade standards from associations such as the Technical Asset Protection Association (TAPA) with their Freight Security Requirements (FSR), Truck Security Requirements (TSR) and Tapa Air Cargo Security Standards (TACSS) plus a myriad of guidance from different governmental departments provides advice on compliance programmes, standards and possible “Red Flags”. Add to these the requirements that come from the International Traffic in Arms Regulations (ITAR), the EU’s Export Control System (ECS), the EU’s Import Control System (ICS), the USA’s pre-departure air cargo screening system (ACAS) and many more. These programmes and standards are intended to ensure that commodities are exported correctly and that the international supply chain in which they are transported is secure. Many companies and particularly service providers such as transport companies have to participate in many if not all of these programmes and also comply with the complex regulations that are in place for the different industries they serve.
Compliance Programmes: Benefits and Costs

Compliance programmes should be a win-win for all participating parties. Compliant businesses should be able to easily recognise other compliant businesses, even when from a completely different industry sector and be able to rest assured that the companies that they deal with will continue to operate within the regulations and guidelines that exist for their business. Arguably regulatory authorities benefit greatly from the participation of business in their various programmes and standards, however the benefit to business continues to be a point of contention. As recognition of their standards and ongoing investment in compliance, compliant companies should receive certain processing simplifications and ‘green channel’ treatment. ‘Green Channel’ is a term frequently used to describe simplified processing, fast track, reduced requirements and other benefits from regulatory and enforcement authorities. It should be easy for business to be able to select a compliant business partner, and therefore maintain the compliance circle, based upon the various compliance programmes, accreditations and associated standards that are important for their industry sector, but there is no simple way of knowing which company has what programme or standard. If there would be a standard database of this information, businesses, regulatory authorities and enforcement agencies would be able to use this data of accreditations to assist with their selection and risk assessment activities.

There is clearly no shortage of compliance programmes and standards. Unfortunately the development of these programmes in isolation by different regulatory authorities and industries sectors requires companies to be accredited for multiple compliance programmes or standards, which in turn are driven by their industry sector, their customers, the nationality of their owners and shareholders and the countries in which they operate, sell to or buy from. A simple transaction from Germany to the USA of communications equipment could see a service provider, in this case transport, being expected to be accredited and participate in at least the following programmes:

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<th>Programmes</th>
<th>Customer</th>
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<td>SSCP Customs</td>
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<td>Service Provider</td>
<td>AEO</td>
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<td>Provider C-TPAT</td>
<td>ECS</td>
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<td>Transport ISO 9000</td>
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<td>Transport TAPA TSR</td>
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*SSCP = Secured Supply Chain Programme

The extraterritorial jurisdictional implications of some countries’ domestic regulations require domestic compliance programmes to be effectively applied within a company’s operations globally. International service providers from for example, the transportation, banking, or insurance industries, are expected to meet the standards of many different industries and countries as their operations span all businesses in one way or another.

Compliance programmes are not all the same, and there are clear industry related differences based upon the relative risk a particular industry has. For companies trading internationally many of these programmes have the same core compliance elements. Therefore companies that are party to multiple programmes may need to have the same elements validated repeatedly. The isolated way in which these programmes have evolved over time and the individual interests of government departments and major companies needing to be doing the ‘right thing’, has resulted in international companies

13 Extraterritorial jurisdiction (ETJ) is the legal ability of a government to exercise authority beyond its normal boundaries.
having to participate in multiple compliance programmes to satisfy the needs of the interested parties. It is not uncommon to hear of companies participating in dozens of different compliance programmes internationally.

The pressure on companies to achieve accreditation in these different programmes and standards has created duplication and even triplication of compliance requirements in many companies. It could be argued that these different programmes, even though they have the same core elements, can create confusion within businesses, employees working with different programmes and possibly even a weakening of compliance standards as a result.

In periods of economic austerity, increasing costs and falling profits, the financial burden placed on industry to have these different programmes in place is considerable. Each programme has considerable financial implications for a company in audit costs, training, management time, and travel which in difficult economic times is a real consideration for business, particularly if the benefits of the programme or standard are unclear to the participants.

The lack of mutual recognition of the different compliance programmes across industry, regulatory authority and country means that internationally, these programmes have limited value, as once you leave the domestic borders of a country there is no possibility for business, the regulatory authorities or enforcers, to recognise a domestically accredited compliance programme.

Probably the most recognised secured supply chain programme is the European Union’s Authorised Economic Operator (AEO). The AEO was introduced in 2007 with the intention of creating a single standard across Member States of the EU and is one of the main elements of the security amendment of the Community Customs Code. AEO is a voluntary programme for which companies will apply to their customs authority for one of the three AEO categories; AEOC – Customs, AEOS – Security and Safety or AEOF which is a combined AEOC and AEOS application. Depending on the EU country where the application is requested, the applicant will be required to respond to questions in up to six questionnaires with details relating to:

- Compliance history
- Record Keeping
- Solvency
- Security

This programme has been the subject of great praise and has now effectively been adopted by the World Customs Organisation. However, participants in the AEO programme are relatively few in view of the number of companies trading internationally. Considering that the programme has been running for over eight years, the European Union’s AEO data for July 2015 shows the number of certificates in place for the 28 EU Member States as 13298, of which 5652 belong to German companies alone. Certificates for major exporting countries such as the United Kingdom and Sweden are surprisingly low at 370 and 316 respectively as of July 2015. Outside Germany, the majority of these certificates have been granted to companies involved in the transportation industry. One possible reason for such a low participation in

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15 AEO categories will change in 2016.
the AEO programme may be that industry in general does not yet see clear benefits for their investment. Despite there being Mutual Recognition Agreements in place with a number of countries, there is no systematic way to recognise an AEO approved company once it leaves the domestic borders of its country. Therefore, once a transaction is in progress, there is no way to recognise the company as being a compliant organisation. This is a challenge for regulatory authorities and for business, as it becomes almost impossible to recognise a compliant business partner.

Towards Achieving an Effective Global Compliance System

As explained so far in this paper, the multi-layered and multi-departmental approach to controls makes compliance overly complex and difficult to understand and implement. Ultimately, this potentially impacts the overall compliance of a business as the risk of errors increases due to the duplication of compliance requirements. It is unlikely that it will be possible to create a truly global compliance programme to satisfy everyone’s needs in the short to midterm, however, if regulatory and enforcing authorities intend to increase voluntary participation in these programmes and increase actual compliance, they will need to find ways of making them more attractive to business, removing duplications from the programmes, minimising financial burden and creating a way for them to be mutually recognised across agencies, industries and international borders.

Alignment of the core elements of the different compliance programmes would go a long way in reducing the physical and financial burden that exists for business today. In parallel to programme alignment, you would also need a method for governments and businesses to access a database that would provide details of companies that are recognised as complying with defined standards. The greatest hurdle to this exists within governments. The nationalistic approach to controls to ensure the individual security or revenues of a country risks losing sight of the collective good for the international community. The sum total of all compliance programmes and standards should be an effective, efficient and compliant global supply chain which benefits all countries and compliant businesses.

The enforcement bodies of many of these requirements and programmes are the customs authorities in each country. The WCO (World Customs Organisation) and the EU have done a lot of good work with the introduction of the AEO programme, despite limited participation in many countries. A mapping of the elements within these different programmes, initially against each other, and comparing them with other existing compliance standards and good practice guides, would be a way of starting the process of removing duplication, reducing costs, and introducing mutual recognition and shared compliance programme data. A major initiative sponsor such as the WTO or WCO would be required to make such an exercise worthwhile.
Conclusion: Improving the Integrity of the Global Supply Chain - Working with Compliant Business Partners

It is difficult if not impossible for both government and industry to identify a compliant business partner in an international transaction. The multiple compliance programmes and standards that companies achieve and maintain, alignment of programmes and the introduction of true and effective mutual recognition would be a powerful tool to improve global security. Unfortunately visibility is currently limited to the industry or enforcement area in which specific business sectors operate. Governments and individual industry sectors have sought to protect their own interests thus creating a multi-layered and often inefficient approach to compliance.

The world is a safer place with these compliance programmes and standards in place. However, there is a major opportunity to improve compliance whilst reducing the cost to business by removing the burden of multiple programmes. A great deal of information exists in relation to the ‘Cost of Non Compliance’ but perhaps now is the time to look at the ‘Cost of Compliance’.