

To the Ministry of Finance

10 October 2014

Recommendation to exclude China Railway Group Ltd. from the investment universe of the Government Pension Fund Global (GPF)

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1 Summary

The Council on Ethics recommends the exclusion of China Railway Group Ltd.¹ (CRG) due to an unacceptable risk of the company being responsible for gross corruption. At the end of 2013, the GPFG owned shares in the company worth NOK 306 million, equivalent to a 0.47 per cent stake in the company.

CRG is one of the largest companies in China's building and construction industry. It has extensive domestic operations and it had operations in 68 countries outside China in 2013. The company has been responsible for developing a number of large railway, road and real-estate projects.

According to information obtained by the Council on Ethics, including information relating to legal rulings and internal disciplinary processes in the Communist Party published in the Chinese press, it is highly likely that CRG has been involved in gross corruption. CRG and one of its subsidiaries have apparently bribed civil servants to secure contracts to build railways and housing projects. This is reflected in two Chinese legal rulings relating to the recipients of the bribes. In addition, the parent company has apparently bribed China's former ██████████ in order to secure major contracts for CRG. In June 2013, ██████████ was convicted in China of taking bribes to award contracts to individual companies for a number of years. The Council on Ethics assumes that CRG knew about its parent company's bribes. This assumption is substantiated by, among other things, the close ties between the parent company and CRG. Reports in the Chinese press also refer to the parent company being one of the companies that have been investigated and sanctioned internally by the Communist Party for having paid bribes.

The Council on Ethics has written to CRG asking for its comments on the accusations and for a report on how it is trying to prevent future violations. The Council has also asked for a meeting with the company in connection with the fact that it held meetings with other companies in Beijing. CRG has confirmed receipt of these requests but has not answered any of them. Nor does the Council have any other information about how the company has reacted to the accusations.

CRG operates in countries and sectors that are known to have a high risk of corruption. The building and construction industry, where large public contracts are common, exposes the company to a considerable risk of corruption. It is the Council's opinion that a company in this given situation is required to have solid systems and measures in place to prevent corruption.

Based on the available information, the Council cannot see that CRG's internal measures for preventing future violations meet such requirements. The systems appear to be defective, among other things because it is unclear which parts of the operations are covered by internal controls intended to reveal dishonest acts. In addition, the systems seem to be insufficient in that several important measures are only aimed at managers and not all employees and that the consequences for employees who contravene laws and internal guidelines are unclear. Nor has CRG established a whistleblowing mechanism that allows all employees to give notice of corruption incidents anonymously and without the risk of subsequent sanctions. Other

¹ The company has Issuer Id: 13437313.

Chinese companies in the same industry seem to place greater emphasis on good compliance systems.

The company's management is to a large extent the same now as when the acts of corruption took place. Numerous members of the board and group management have held management positions in CRG since 2007 and several of them also held senior management positions in the parent company at the time when the acts of corruption apparently took place.

The Council further assumes that the recent and extensive anti-corruption initiatives in China may play an important role in preventing corruption in Chinese companies. This recommendation concludes nonetheless that there is an unacceptable future risk of corruption in CRG mainly based on the fact that the Council places more weight on the company's reactions to the acts of corruption revealed as well as on the measures that the company has implemented to prevent future corruption.

Based on the information available, the Council finds it highly likely that CRG has been involved in gross corruption and that the company does not meet national or international standards regarding compliance and anti-corruption. The Council therefore recommends excluding CRG from the investment universe of the GPFG.

2 Introduction

In 2012, the Council on Ethics conducted a study of countries and sectors with the objective of identifying companies with a special risk of corruption in the GPFG's portfolio. The study is based on international corruption indices, including Transparency International's (TI) *Bribe Payer Index*,² TI's *Global Perception Index*³ and the World Bank's *Worldwide Governance Indicators*.⁴ These findings formed the basis for more detailed examinations. According to the *Bribe Payer Index*, which ranks 28 leading export countries according to the likelihood of their companies having corrupt operations abroad, Russia and China came last, followed by Indonesia and Mexico. The building and construction industry is also regarded as the sector that is most exposed to corruption. The same countries also came last in the *Global Perception Index* and *Worldwide Governance Indicators*.

Based on the country and sector study, the Council on Ethics identified all the portfolio companies with building and construction operations that are registered in China, Russia, Indonesia and Mexico, as well as all the companies in the GPFG portfolio with operations in the same sector and countries, a total of 365 companies. A limited number of companies, including CRG, were examined in further detail based on specific accusations of corruption.

At the end of 2013, the GPFG owned shares in CRG worth NOK 306,000,000, equivalent to a 0.47 per cent stake in the company.⁵

² The most recent report was published in 2011 and is available at <http://bpi.transparency.org/bpi2011/results/> (13 August 2014).

³ The report for 2013 is available at <http://www.transparency.org/cpi2013/results> (13 August 2014).

⁴ The indicators for 2014 are available at <http://databank.worldbank.org/data/views/variableselection/selectvariables.aspx?source=Worldwide-Governance-Indicators> (13 August 2014).

⁵ Available at <http://www.nbim.no/fondet/beholdninger/beholdninger/> (13 August 2014).

2.1 What the Council has considered

The accusations of corruption against CRG and its subsidiary relate to the bribing of civil servants to secure construction contracts in China. The Council on Ethics has considered whether there is an unacceptable risk of CRG being responsible for gross corruption according to section 2, subsection 3, letter d) of the ethical guidelines.⁶

The Council has previously adopted the following definition for its assessments of the concept of gross corruption:⁷

Gross corruption exists if a company, through its representatives,

- a) gives or offers an advantage – or attempts to do so – in order to unduly influence:*
 - i) a public official in the performance of public duties or in decisions that may confer an advantage on the company; or*
 - ii) a person in the private sector who makes decisions or exerts influence over decisions that may confer an advantage on the company,*
- and*
- b) the corrupt practices as mentioned under paragraph (a) are carried out in a systematic or extensive way.*

The Council first considered whether it is highly likely that CRG has committed acts that comprise gross corruption according to the above definition. Thereafter, the Council considered whether there is an unacceptable risk of the use of gross corruption continuing. Both these conditions must be met in order for the Council to recommend the exclusion of a company under the corruption criterion.

In its overall assessment, the Council has placed emphasis on the company's previous involvement in acts of corruption, the scope of the corruption and the company's reactions to the accusations of corruption. Emphasis has also been placed on the company's internal compliance systems.⁸ The objective of a company's compliance system is to prevent, discover and penalise breaches of internal and external laws and regulations. The internal compliance system can therefore say something about the risk of unlawful acts continuing in the future. This forms one of several elements in the assessment of whether there is a future risk of continued corruption. In this case, the Council has also placed emphasis on risk elements such as the countries and sectors in which the company operates.

⁶ Section 2, subsection 3 of the guidelines states: "(3) The Ministry of Finance may, on the advice of the Council on Ethics, exclude companies from the investment universe of the Fund if there is an unacceptable risk that the company contributes to or is responsible for: d) gross corruption...".

⁷ Refer to the Council on Ethics' recommendation to exclude French company Alstom SA, 1 October 2010, http://www.regjeringen.no/upload/FIN/etik/2011/Alstom_norsk.pdf.

⁸ Etterlevelsessystemer (in Norwegian) means the same as *compliance* systems.

2.2 Sources

There is less publicly available information in this case than in previous cases in which the Council on Ethics has recommended the exclusion of companies responsible for gross corruption.

The information that has been obtained comes from the Chinese and international press as well as from the company's annual report and website.⁹ The publicly available information that exists often comprises quite general references to the corruption cases. The Council has therefore conducted two extensive investigations of accusations that have appeared in the press. It has also obtained information from persons who have had direct access to criminal cases and the disciplinary sanction processes that the Communist Party has conducted in relation to the parent company.

The assessment of the company's compliance systems is based on information that is published on CRG's own website or has been obtained through the Council's own investigations. The Council has also consulted other sources in China, Germany and the UK in order to obtain information on specific cases and general information on the anti-corruption work in the building and construction sector and state-owned companies in China.¹⁰

The Council has asked CRG for information several times, among other things about whether the Council on Ethics' information on the company's involvement in corruption in China is correct and about any measures that have been implemented to prevent future violations. The Council has also requested a meeting with CRG but this has not come about.

3 Background

3.1 About CRG

CRG is a subsidiary of the state-owned China Railway Engineering Corporation (CREC).¹¹ It was established in 2007 and is currently listed on the Shanghai and Hong Kong stock exchanges.¹² As one of the largest companies in the building and construction sector in China, most of its operations are related to the building of railways and motorways. The company also has property-development operations, consultancy operations and mining operations in some African countries. In 2013, the company reported total revenues equivalent to NOK 540 billion of which NOK 456 billion came from infrastructure projects.¹³

⁹ The Council has been unable to obtain copies of court rulings or other public documents linked to the corruption cases in which CRG, its subsidiary or their employees have been involved since these documents have not been made public.

¹⁰ This applies to persons with links to recognised international voluntary organisations, academics and journalists.

¹¹ The parent company is China Railway Engineering Corporation (CREC). CREC runs its operations through its main subsidiary, which is CRG – refer, for instance, to http://www.hoovers.com/company-information/cs/company-profile.China_Railway_Engineering_Corporation.4792a5ba04ae896a.html. CREC owns 56.1 per cent of the shares in CRG. HKSCC Nominees owns 19.45 per cent, while the other shares are owned by a large number of small shareholders, refer to www.sina.com and www.ifeng.com (Phoenix).

¹² Shanghai Stock Exchange stock code 601390 and Hong Kong Stock Exchange stock code 390.

¹³ *CRG Annual Report 2013*, http://www.mzcan.com/china/601390/financial/13/EN/2013_per_cent20Annual_per_cent20Report_pDn9t62criDI.pdf.

Most of the operations are carried out in China, but in 2013 the company also reported having operations in 68 other countries.¹⁴ In December 2013, the company had almost 290,000 employees. CRG has 46 subsidiaries.

4 Accusations of corruption

4.1 CRG involved in one of China's biggest corruption cases

In July 2011, a disastrous accident took place involving high-speed trains in Wenzhou. Forty people died in a collision between two trains. The investigation into the accident revealed what in 2003 was called the biggest corruption case in China. Key to the case were three people with close ties to each other who were prosecuted for corruption. These were [REDACTED], the former [REDACTED] of China Railway Container Transport and China Railway Tielong Container Logistics Co., [REDACTED] from 2003 to 2011, and [REDACTED], an agent for the companies. CRG was apparently involved in all the cases.

In 2012, [REDACTED] was accused of corruption in that, between 2005 and 2010, he had apparently received monetary amounts equal to around NOK 47 million from several companies, including CRG and its subsidiary China CREC Railway Electrification Bureau Group. The acts of corruption relate to the award of railway contracts in the Chinese provinces of Xinjiang and Inner Mongolia.¹⁵ The court case is apparently now over but there is no publicly available information on the outcome.

The largest case concerned [REDACTED]. On 8 June 2013, he was convicted of having taken the equivalent of NOK 64 million in bribes in return for awarding railway contracts to specific companies. During the main hearing at No. 2 Beijing Intermediate People's Court, [REDACTED] pleaded guilty.¹⁶ Shortly afterwards, he was sentenced to death for corruption and the abuse of power. This sentence was later commuted to lifelong imprisonment.

[REDACTED] was the driving force behind the modernisation of China's railway system. During the five-year period from 2005 to 2010, he managed a budget equivalent to NOK 1,900 billion. In comparison, the budget was NOK 18.3 billion for the 1992-1998 period and NOK 29.4 billion

¹⁴ In its CSR report for 2013, the company states it has operations in 68 countries, and also writes: "At present, 338 overseas construction projects have been involved in railways, highways, bridges, tunnels, housing construction, urban rail, municipal engineering, water conservancy, port construction and other fields in 59 countries and regions of South America, Eastern Europe, Africa, South-Pacific, Southeast Asia, the Middle East etc. Company's products of turnouts, the steels structures and others are exported to 20 countries and regions of the United States, Canada, Denmark, Germany, New Zealand, Hong Kong, Indonesia, Sri Lanka, Cambodia, Thailand, Vietnam, Sierra Leone, Venezuela, Bengal, Zambia, Scotland, India, Thailand, South Korea, Laos, and others. In addition, the company invested in Mali textile mills and Ivory Coast pharmaceuticals overseas, and also developed the business of real estate in South Africa, and project of mineral resource exchanging for infrastructure in Africa such as Congo-Kinshasa and so on. It not only promoted local economy development, but also provided employment service to some extent for the local people." The report is also available at <http://www.crecg.com/tabid/383/Default.aspx>. In its annual report for 2013, the company also states it has operations in Ethiopia, Congo (DR), Georgia and Malaysia, refer to the CRG Annual Report 2013, available at http://www.mzcan.com/china/601390/financial/13/EN/2013_per cent20Annual per cent20Report_pDn9t62criDI.pdf.

¹⁵ Refer to the *Caixin Online* article dated 27 December 2012, available at <http://english.caixin.com/2012-12-27/100477785.html>, and the *South China Morning Post*, 30 December 2012, available at <https://tinyurl.com/state-firms-paid-bribes>. There is no publicly available information on the outcome of the court case.

¹⁶ Refer to the *South China Morning Post*, 9 June 2013, <https://tinyurl.com/graft-trial-begins>.

for the 1998-2003 period.¹⁷ In 2005, public tendering requirements were introduced in the railway sector. It is assumed that this, together with the huge increase in the budgets, may have created the basis for widespread corruption.

As a result of the corruption case against ██████████, the Ministry of Railways was dissolved in 2013 and its operations were placed under other bodies.¹⁸

The payment of bribes

Several Chinese press articles refer to the fact that CRG is involved in ██████████ corruption case.¹⁹ The parent company, CREC, is apparently one of the companies that paid him bribes through the agent ██████████ with the aim of securing contracts for CRG. The parent company is also one of several companies that have apparently been investigated and penalised internally by the Communist Party for having bribed ██████████²⁰ During ██████████ time, at least 80 per cent of all the railway contracts were apparently awarded to CRG and China Railway Construction Corporation. The other contracts were awarded to China Communications Construction Co., China Construction Group and a couple of local construction companies.²¹ ██████████ is assumed to have received in total a far higher amount in bribes than those he was convicted for.²²

The last of the three big corruption cases concerned ██████████, a businesswoman who in September 2013 was tried at No. 2 Beijing Intermediate People's Court. Apparently, she was for many years the "middleman" between the Ministry of Railways (i.e. ██████████) and several companies that submitted tenders for railway projects. The prosecutor presented documentation showing that, through ██████████ ██████████, she had paid ██████████ around NOK 48 million in return for him awarding railway contracts to companies that she recommended. During the court case, it was confirmed that she was ██████████ middleman and that she was the person who, on behalf of the companies, personally paid most of the bribes to ██████████²³ Her company is assumed to have earned NOK 3 billion on illegal services, including "consultancy fees" for railway projects awarded by high-ranking civil servants like ██████████²⁴

¹⁷ A consultant's report dated 28 March 2014. For a description of the developments in the former Ministry of Railways, refer to <http://www.softwarestesting.no/chinarail/chinarailinfo/chinarailstatistics.html>, and <http://siteresources.worldbank.org/INTTRANSPORT/Resources/336291-1152714163458/2744896-1152794646430/zhang-jp-mor.pdf>

¹⁸ The functions relating to *safety and regulation* were transferred to the Ministry of Transport, while the *construction and rail-management* functions were taken over by a new company, China Railway Corporation (CRC). The new State Railway Administration is responsible for supervising CRC.

¹⁹ Refer, among other things, to the *Jiefang Daily*, 9 August 2012, <http://data.jfdaily.com/a/3741795.htm>, <http://ccnews.people.com.cn/n/2012/0809/c141677-18701508.html>; *Caixin Online*, 5 August 2012, <http://companies.caixin.com/2012-08-05/100419665.html>, *South China Morning Post*, 9 June 2013, <https://tinyurl.com/graft-trial-begins>, *The Guardian*, 8 July 2013, <https://tinyurl.com/sentenced-death-corruption>, and *www.today.online* 8 July 2013, <https://tinyurl.com/sentenced-death-for-corruption>.

²⁰ *Jiefang Daily*, 9 August 2012, <http://data.jfdaily.com/a/3741795.htm>, *Caixin Online*, 5 August 2012, <http://companies.caixin.com/2012-08-05/100419665.html>, *Xinua*, 6 August 2012, http://news.xinhuanet.com/legal/2012-08/06/c_123535746_2.htm. According to experts on China, the report on, for instance, CRG's parent company in these press articles clearly refers to internal sanction processes in the Party.

²¹ Refer to *Caixin Online*, 2 March 2011, <http://english.caixin.com/2011-03-02/100231179.html?p1>.

²² Refer, for instance, to *The Guardian*, 8 July 2013 <https://tinyurl.com/for-corruption-sentenced-death>. (13 August 2014).

²³ Refer to the *China Daily*, 25 September 2013, http://europe.chinadaily.com.cn/china/2013-09/25/content_16991631.htm.

²⁴ Refer to *Caixin Online*, 9 September 2013, <http://english.caixin.com/2013-09-09/100579840.html>.

The managers hold positions in both CRG and the parent company

The management of CRG apparently also knew about the bribes from the parent company. This is supported by the fact that the current CEOs and legal director, as well as several other key managers in CRG, also held important positions in the parent company during the years when the acts of corruption apparently took place. Several of these, in addition to the company's former president, held key positions in the parent company even before the acts are alleged to have taken place. The company's annual report for 2013 states that:

- CRG's president until 2014 was a vice executive president of the parent company from 2006 to 2007.
- CRG's current chair of the board, who is also the CEO, has held both positions in CRG in parallel since 2010. From 2002 until 2006, he was the deputy CEO of the parent company. From 2006 until 2010, he was a director of the parent company. He has been the chair of the parent company's board since 2010 and the CEO of the parent company from June 2010 until March 2013.
- The deputy chair of CRG's board, who is also the CEO, has held management positions in CRG since 2007.²⁵ From 2006 to 2008, he was the director of the Labour Union in the parent company. In 2010, he also became the deputy chair and was appointed to another management position in the parent company, and since 2013 he has been the General Manager of the parent company.
- The legal director in CRG since 2014 was the secretary of CRG's board from 2010 to 2014. He held management positions in the parent company from 2000 to 2007.²⁶

4.2 Other accusations of corruption with links to CRG

On 1 November 2012, a high-ranking civil servant in Hainan Province was sentenced to life imprisonment for having received more than NOK 16 million in bribes from CRG. Up to the date of his arrest, the company had allegedly paid state employees a total of NOK 20 million in illegal kick-backs to secure contracts relating to a housing project with an estimated value of NOK 770 million.²⁷

4.3 Accusations of taking bribes

There are several legal rulings against CRG employees which state that the parties involved have taken bribes. Ten of CRG's subsidiaries have allegedly received a total of NOK 660,000 in bribes from Sany Heavy Industry.²⁸ In May 2012, [REDACTED], a former [REDACTED]

²⁵ CRG's annual report for 2013 states that the company has two CEOs, referred to as "overlapping executive directors" – see the *CRG Annual Report 2013*, http://www.mzcan.com/china/601390/financial/13/EN/2013_per cent20Annual per cent20Report_pDn9t62criDI.pdf.

²⁶ The chair of CRG's *Supervisory Committee* since 2010 has held other management positions in CRG since 2007. He also held management positions as the *Deputy Chief Economist* in the parent company from 2004 to 2006 and was among other things the secretary of the parent company's *Disciplinary Committee* from 2006 to 2013. An adviser to the company (*Supervisor*) was the head of the *Audit Department* in CRG from 2007 to 2013 and was at the same time a key adviser to the parent company from 2007 to 2014. Four other persons that have held vice president positions in CRG since 2007 held management positions in the parent company between 1997 and 2008. Refer to the company's annual report published in 2013, *CRG Annual Report 2012*, page 30 et seq, available at http://www.mzcan.com/china/601390/financial/11/EN/2012_per cent20Annual per cent20Report_A2RNi1FLC717.pdf.

²⁷ Refer to the *21st Century Business Herald*, 1 November 2012, only available in Chinese, <http://money.163.com/12/1101/11/8F7LRI6900253B0H.html>.

²⁸ Refer to the *China Economic News*, 27 April 2011, only available in Chinese, http://news.xinhuanet.com/fortune/2011-04/27/c_121351988.htm.

of CRG's wholly owned subsidiary China Railway and Aviation Construction Group Corporation, was sentenced to 11 years' imprisonment for taking bribes.²⁹ In May 2010, [REDACTED], the former head of a construction project carried out by CRG's subsidiary China Railway First Group Construction Installation Engineering Co. Ltd, was sentenced by the Intermediate People's Court in Shenyang in Liaoning province to five years' imprisonment for taking bribes.³⁰

5 Chinese and international anti-corruption standards

The existing anti-corruption regime in China is complex due to the overlapping of the state measures to prevent corruption and the Communist Party's own anti-corruption disciplinary system. The state combats corruption by prohibiting corruption in legislation, by the police and courts investigating cases,³¹ and by the courts imposing sentences. The Communist Party has a parallel system for legislation, investigation and the imposition of disciplinary sanctions when rules are violated.

During the past few decades, increasingly stringent anti-corruption requirements for state-owned and private companies have emerged. This applies both within China and internationally.³² While all civilians and legal entities are subject to state regulation and control, all Communist Party members are also subject to the Party's control system. In that anyone in a key position in a state-owned company is a member of the Communist Party, the Party's control and sanction system is probably the most important anti-corruption tool in China.³³

The information obtained by the Council on Ethics shows that corporate governance and internal control requirements have been introduced in order to strengthen the companies' internal anti-corruption procedures. A state-owned company is generally expected to focus on integrity and morals as well as on anti-corruption procedures. In order to achieve control, anti-corruption training is to be carried out, among other things. It is normal practice to have a

²⁹ Refer to the *Beijing Times*, 28 May 2012, only available in Chinese.

³⁰ Se *Xhinua*, 24 May 2010, and the *Liaoning Evening News*, 20 May 2010, only available in Chinese.

³¹ Chinese criminal procedures are based on inquisitorial principles. It is common for the judge assigned to prepare a case for trial to be in charge of the investigation in a serious criminal case.

³² For international standards on compliance and anti-corruption measures, refer to the general principles stated in the UN *Global Compact* and *OECD guidelines for multinational companies* and the standards based on national legislation, especially the *US Foreign Corruption Prevention Act (FCPA)* and *UK Bribery Act*, refer to footnote 39.

³³ Important national anti-corruption legislation and regulations are stated in *PRC Criminal Law* (refer, for example, to article 393 regarding corporate penalties, which also covers state-owned companies that offer bribes), *PRC Company Law*, and *Interpretations issued by the Supreme People's Court, the Supreme People's Procuratorate, or the State Administration for Industry and Commerce*. In addition, the *Rules Governing the Listing of Stocks on the Shanghai and Shenzhen Stock Exchange*, which are intended to clarify the individual anti-corruption rules in *PRC Company Law*, also apply. According to these rules, listed companies must, within a reasonable period, announce any crimes committed by directors, advisers or senior employees. The *PRC Bidding Law* also applies and, among other things, stipulates that all major public contracts must be awarded following prior competitive tendering and that bribes given for the award of contracts are prohibited, cf. 32. Contraventions that qualify as crimes are to be prosecuted in accordance with the penal code, cf. Article 53. On 25 December 2013, the General Office of the CPC Central Committee issued a *Plan for Establishing and Improving the Work of Punishing and Preventing Corruption (2013-2017)* ("2013-2017 Work Plan") in order to strengthen the Party organisation at all levels, establish internal anti-corruption systems and improve compliance. Normally, key companies (*key State Owned Enterprises*) publish their internal anti-corruption procedures (i.e. proposed internal anti-corruption rules and mechanisms) based on the newest version of the Work Plans. CRG has not yet published any timetable for implementing the *2013-2017 Work Plan*.

policy for building a good internal corporate culture. In addition, many companies have their own tendering strategy based on national tendering rules. Many companies have also established an advisory body or expert group that advises on how the anti-corruption work should be implemented in the company's operations. In addition, an audit is to be conducted in the normal way and, to ensure independence, the companies should use an external auditor. Many companies, especially the state-owned ones, have established procedures to make managers responsible for any failure to implement anti-corruption laws and regulations.

Whistleblowing channels are regarded as an important part of a company's anti-corruption system in order to reveal acts of corruption. Most private and state-owned companies in China have established whistleblowing systems such as a *hotline*, other anonymous notification channels, online whistleblowing centres and internal complaints systems for employees. In order to adapt to international compliance standards, most state-owned companies have also established an internal legal advice group to ensure the correct implementation of and checks on anti-corruption rules in the company.³⁴

State-owned companies are obliged to establish a Communist Party organisation within the company that functions as a supervisory body. All state-owned companies are also monitored externally by the *Central Commission for Discipline Inspection* (CCDI), which is the supreme body for monitoring the Party's disciplinary system.³⁵ The objective is to limit extravagance, the abuse of power and corruption. It has also become more common for companies to publish internal anti-corruption procedures on their websites.³⁶ In 2011, a new penal provision was introduced prohibiting foreign bribery. The *Ministry of Commerce* published supplementary guidelines to the Act in 2013.³⁷

³⁴ This was introduced with the *Notification on Further Accomplishing the Experimental Work for Enterprises' General Legal Advisers* and associated statements. A *General Legal Adviser* is to help the company correctly implement state rules and regulations, take part in decision-making procedures, provide legal opinions on how legislation is to be interpreted, be responsible for legal issues by monitoring or taking part in the company's largest financial activities, be in charge of the company's legal units, handle tendering processes and court cases, train legal advisers in the company and propose corrections and sanctions if laws or regulations are contravened in other company departments.

³⁵ CCDI is authorised to investigate and impose sanctions regarding all anti-corruption rules in China. The sanctions for contravening the Party's disciplinary rules are warnings, loss of title and exclusion from the Party. If there is a breach of the penal code, the case may be transferred to the courts for ordinary prosecution. Whether or not this is done depends on the circumstances. In addition to the CCDI, there are a number of state bodies in China that monitor and check that the prevailing regulations are complied with and investigate assumed crimes. These include the *Party's Central Commission for Discipline Inspection* (political body), *National People's Congress* (legislative body), *People's Courts and People's Procuratorates* (bodies connected with the courts), *Ministry of Supervision* (administrative supervisory body) and *National Bureau of Corruption Prevention* (anti-corruption body). Relevant rules applicable to the Party's disciplinary system are *Various Rules on Probity in Governance for Member Leaders and Cadres of the Communist Party of China* and *Measures for the Implementation of the Guidelines of Communist Party and China for Party-member leading Cadres to Perform Official Duties with Integrity*. The first guidelines, which entered into force on 18 January 2010, contain a number of definitions of corrupt actions. The second guidelines, which entered into force on 22 March 2011, provide detailed sanctions for breaches of the rules.

³⁶ The company that can be regarded as the most comparable with CRG in China as regards size and sector has, for example, published detailed information on its internal anti-corruption system on its website.

³⁷ Chinese multinational companies and their employees are subject to China's penal code, which is explicitly referred to in the 2011 supplements to *PRC Criminal Law*. Article 164, which was revised on 25 February 2011, prohibits any kind of corruption relating to Chinese citizens and other legal entities operating in China or abroad. The article's second subsection specifies that anyone who gives an asset to an employee abroad or an employee of a public organisation in order to achieve "*any improper commercial benefit*" is to be punished for corruption. The Ministry of Commerce also agreed on the following guidelines – *Key Points of the Ministry of Commerce on Regulating the Overseas Business Operations of Enterprises and Preventing and Controlling*

The state-run State-Asset Supervision and Administration Commission (SASAC) is responsible for managing the state-owned companies, including ensuring that the appointment of managers complies with laws and regulations. The SASAC conducts regular checks in large state-owned companies. According to Chinese law, a company may be held liable for acts of corruption committed by its managers, employees or others acting on behalf of the company and be subjected to criminal-law, civil-law and administrative sanctions.³⁸

The main features of international standards for companies' anti-corruption and compliance systems are that the management must clearly and expressly show that the company may not take part in corrupt acts and that any kind of corruption is prohibited. An anti-corruption programme must be established aimed at ensuring the company's operations comply with relevant anti-corruption laws and regulations. The compliance systems must be adapted to the company, i.e. its size, local and regional conditions and the sector in which the company operates. In order to ensure that the procedures are implemented, the company must among other things have a training programme for all employees and everyone must be informed about the consequences of violating the rules. An external whistleblowing channel should be established so that all employees can freely give notice of possible violations. Non-conformances must be logged and reported to the management – and dealt with. The company's attitude to anti-corruption should also be communicated to third parties. The procedures should be monitored by an independent body and evaluated and improved regularly.³⁹

6 Information from CRG

6.1 CRG's compliance systems

The information that the Council on Ethics has about CRG's internal compliance and anti-corruption procedures is to a large extent based on a working paper dated 28 December 2011 and written by Wang Qiuming, the head of the *CRG Supervision Department*.⁴⁰ In addition, the company's CSR reports for 2012 and 2013 to some extent refer to compliance and anti-corruption procedures.⁴¹

Overseas Commercial Bribery – on 27 February 2013. Since the law is relatively new, there have until now been few cases in China relating to foreign bribery.

³⁸ Refer to article 30 of PRC Criminal Law which also refers to Chinese Supreme Court law, cf. article 43, cf. article 63 of the General Principles of the Civil Law of PRC, and cf. the Interim Regulations of the State Administration for Industry and Commerce on Prohibition of Commercial Bribery issued by the SAIC, refer to <http://www.nortonrosefulbright.com/files/anti-corruption-laws-in-asia-pacific-63559.pdf>. The law allows it to be decided only to prosecute individuals and not companies, based on the need to protect jobs and the local economy.

³⁹ Reference is made to the general principles stipulated in *The OECD Guidelines for Multinational Enterprises*, <http://www.oecd.org/daf/inv/mne/48004323.pdf>. The *UK Bribery Act* and *Foreign Corruption Prevention Act (FCPA)* have also provided guidance for international standards relating to the prevention of corruption in companies. In 2011, the UK Ministry of Justice published a guide on how companies should act to avoid criminal liability pursuant to the UK Bribery Act. This guide is available at <http://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf>. In 2012, the US Department of Justice (DoJ) and US Securities and Exchange Commission (SEC) published a guide on how companies should act to avoid criminal liability pursuant to the FCPA, and this is available at <http://www.justice.gov/criminal/fraud/fcpa/guide.pdf>.

⁴⁰ The working memo is available from the *Party Construction Website* for Chinese companies, <http://www.qiyedangjian.com/html/dangqunhuiyi/dangdahui/2012/0112/10613.html> (it was available in Chinese until May 2014).

⁴¹ The report for 2012 was probably the first CSR report published by CRG.

As a partly state-owned company and in accordance with Chinese law, CRG has apparently established two bodies to provide advice on preventing corruption and handling violations in the company. These are the *CRG Supervision Department* and *Discipline Inspection Commission of the Party Committee*. The former is responsible for giving advice and investigating and handling any breach of laws or regulations. The latter is responsible for providing advice and investigating and handling any breach of the Communist Party's disciplinary rules.

According to Wang's working paper prepared in 2011, the company has established internal anti-corruption systems to ensure that the state's anti-corruption provisions and the political disciplinary rules are complied with. The working paper mentions several documents relating to internal control mechanisms, but these documents are either not published in full or are internal procedures that have not been fully established and implemented.⁴² Based on regulations issued by the CCDI, the company agreed on *CRG Detailed Rules for the Implementation of the Regulations on Probity and Self-discipline for the CRG Leaders* in 2008.⁴³ These rules prohibit corruption and state five definitions of corruption. However the rules only apply to employees above the middle-management level in CRG and its subsidiaries. To ensure that the rules are implemented, the company has issued five supporting documents.⁴⁴ Another set of rules, called *CRG Interim Provisions on the Implementation of the Accountability System for CRG Leaders*, has been issued by the *CRG Party Committee* and also only applies to managers in CRG as well as managers of wholly owned and direct subsidiaries. This set of rules defines the responsibility for the choice of employees, project management and the use of money, production accidents, failure to implement CRG's provisions, orders and other acts that affect the state's, company's and employees' interests. However no specific sanction procedures are stipulated for any breach of the rules.⁴⁵

Wang's work report also states that, from 2006 to 2011, the company established various anti-corruption measures, including an online training base and interviews with managers. The report states that there is a system for the periodic anti-corruption training of all employees but this is not specified in any greater detail. It also states that CRG conducts inspections of all subsidiaries and major projects in CRG.⁴⁶

⁴² In 2010, for example, the company apparently carried out a project relating to an internal anti-corruption manual, called the *Project Anti-Corruption Manual*, but there is no publicly available information about this apart from it being mentioned in Wang's working paper. The same applies to the *Notice of CRG on Measures for Establishing and Improving the Education, System, and Supervision of Punishing and Preventing Corruption*.

⁴³ Available at <http://www.crecg.com/tabid/461/InfoID/10410/frtid/424/Default.aspx> (14 August 2014).

⁴⁴ These are the Interim Measures on Probation Period of CRG Leaders, Interim Measures on Term of Office of CRG Leaders, Interim Measures on Elimination of Incompetent CRG Leaders, Provisions Against Monetary Income Except for Annual Salary of CRG Leaders and Provisions Against the Purchase of Service Cars. However, Wang's working paper from 2011 only refers to the titles of these documents and the Council on Ethics has not managed to obtain any additional information about the more detailed content in any other way.

⁴⁵ In that all the key positions in CRG are, in accordance with the Chinese constitution, held by members of the Communist Party, all these managers are to be appointed and managed by the *Party Committee* in the company.

⁴⁶ According to Wang's working report, the *CRG Supervision Department* also published an anti-corruption manual in 2009, the *Alarm Bell*, which presents 29 different corruption cases. However, the full wording of the anti-corruption manual is not publicly available, and the manual is only referred to in the working report. The same applies to the *CRG Anti-corruption Manual*, which is another manual and applies to the entire CRG

In the CSR reports for 2012 and 2013, CRG writes that it operates "in accordance with national rules". Reference is made to several national and international anti-corruption guidelines on which the company bases its operations.⁴⁷ However, the reports contain no information on how these guidelines are applied in the company's internal management. The reports also have a separate chapter on internal controls and supervision, but do not state which parts of the operations that are controlled and supervised or how this is carried out. CRG introduced separate rules for public procurements ("*Bidding Law*") in 2012. In the 2013 report, the company writes that: "*In 2013, CREC has strictly implemented the Bidding Law during the market exploring and operating, taken part in hundreds of biddings all year around, without one case of unhealthy operating behaviour*".⁴⁸

According to Wang's working paper prepared in 2011, there are procedures for implementing internal anti-corruption measures. The company has prepared a *CRG Interim Provisions* responsibility procedure. This is used by the *Supervision Department* and *Discipline Inspection Commission* to discover which manager is responsible for an assumed violation. However, no reference is made to procedures for holding individuals responsible. The document also states that the company aims to establish whistleblowing procedures,⁴⁹ but this has not yet been done. There is no further information on the implementation of internal anti-corruption measures.

On 12 June 2013, the SASAC carried out its fourth check on CRG. The main objective of this was to inspect the implementation of the Party's disciplinary and anti-corruption measures in CRG and to provide advice on these questions.⁵⁰ Neither the SASAC nor CRG has published the inspection report.

6.2 The Council on Ethics' contact with CRG

The Council on Ethics sent CRG a letter on 23 July 2013 asking the company to comment on the specific accusations of corruption involving CRG. The company was also asked to provide information on its internal anti-corruption and compliance systems. CRG has also had an opportunity to comment on the draft of this recommendation. The company has confirmed receipt of the enquiries but has not replied.

In June 2014, the Council on Ethics held meetings in Beijing with two of the other companies that the sector study considered to have a particularly high risk of corruption and CRG was contacted in order to arrange a meeting. This request also remained unanswered.

Group, including subsidiaries. Its main objective is to strengthen the employees' attitude to corruption. This document is not publicly available either.

⁴⁷ These are the United Nations Global Compact, The Global Reporting Initiative (GRI), Social Accountability International (SAI), China CSR Reporting Guidelines (CASS-CSR2.0), Guide on Social Responsibility for Chinese International Contractors and Relevant requirements of the SASAC - refer to the CSR reports for 2012 and 2013.

⁴⁸ Refer to the *CSR Report* 2013, page 21. Refer also to the *CSR Report* 2012, page 21 - both reports are available at <http://www.crecg.com/tabid/383/Default.aspx> (14 August 2014).

⁴⁹ Refer to Doc88 Database, <http://www.doc88.com/p-9488732954371.html> (only in Chinese, 14 August 2014).

⁵⁰ Refer to <http://www.crecg.com/tabid/461/infoid/22998/frtid/111/default.aspx>.

7 The Council on Ethics' assessment

Based on the existing documentation, the Council has considered whether CRG should be excluded based on the corruption criterion in the GPFG ethical guidelines.

The Council starts off by deciding whether it is highly likely that the company has committed acts which, according to the guidelines, comprise gross corruption, including whether the corruption has been carried out in an extensive and/or systematic way. The Council's assessments take into account the fact that corporate penalties exist in China but have not been applied to CRG.

Based on the criminal cases involving CRG and its subsidiary China CREC Railway Electrification Bureau Group, the Council believes it is highly likely that CRG has committed acts that must be counted as gross corruption. It has not been possible for the Council on Ethics to obtain access to information on specific details in the corruption cases, among other things because judgments are not published. However, several cases of corruption are publicly known and have been referred to in the Chinese press, including the *Jiefang Daily*, which is the official newspaper for the Shanghai Department of the Communist Party. Based on the available information, the Council on Ethics finds that both CRG and its parent company have bribed civil servants to secure railway contracts for CRG and that CRG has in at least one case bribed civil servants to secure a construction contract in connection with a housing project. The Council also finds that the subsidiary, China CREC Railway Electrification Bureau Group, has bribed civil servants to secure a public railway contract.

The size of the amounts indicates that CRG's management knew or ought to have known about all these payments. In the two court decisions from 2012 that the Council knows about, the corruption amounts appear to be high. The same is true for the corruption amounts that were paid to the former [REDACTED]. The Council does not know the exact size of the amounts or the number of times he was bribed by the parent company. However, based on the information stated in references to the criminal case against [REDACTED] and [REDACTED] including the fact that these concerned public contracts of considerable value that were awarded from 2005 to 2011, the Council believes it is highly likely that the bribes were large and paid over a lengthy period of time. The Council therefore believes that the acts must be characterised as both extensive and systematic.

The next item to be considered by the Council is whether there is an unacceptable risk that the company's use of gross corruption will continue.

The Chinese authorities have come down hard on corruption recently. An aggressive anti-corruption campaign has been implemented to combat corruption, primarily in state bodies, and the authorities have stated they will target both "tigers and flies". As part of an attempt to eradicate corruption in the railway sector, the Ministry of Railways was reorganised in 2013. In addition, there is now a statutory prohibition against foreign bribery. The Council believes that, seen in isolation, these important, authority-initiated measures indicate that the risk of extensive and/or systematic corruption has been reduced in companies like CRG. However, the conclusion of this recommendation is nonetheless that there is an unacceptable future risk of corruption in CRG because the Council places more emphasis on the way that the company has responded to the acts of corruption which have been revealed in the company and on the measures that the company has implemented to prevent future corruption.

Three elements have together been crucial to the Council's assessment. The first is that CRG does not seem to be doing enough to prevent future violations. The second is that the people

who managed the company when the acts of corruption took place are still managing the company. The third is the level of corruption in the countries and sectors in which CRG operates.

Based on the actual acts of corruption and Chinese and international anti-corruption standards, the company should be expected to state, in a dialogue with the Council or in some other way, that corruption within CRG is unacceptable. In the same way, the company should be expected to clearly state that it has implemented or is making efforts to implement measures to prevent corruption. However, there is not enough publicly available information about the company's internal anti-corruption procedures to ascertain that CRG is doing this, and in addition the company has refused to reply to the Council's request for information on these issues.

Based on the available information, the Council cannot see that CRG's internal anti-corruption measures contain the elements that it is reasonable to expect of a large company operating in countries and sectors that are particularly vulnerable to corruption. The current management's attitude to corruption is unclear to the Council. CRG also seems to have anti-corruption procedures but it is not fully known what these comprise and how they are implemented, monitored and evaluated.

The internal compliance systems seem to be insufficient, especially because it is unclear which parts of the operations are covered by internal controls aimed at revealing dishonest acts. It also seems to be insufficient that several important measures are only aimed at managers and not at all employees and that the consequences for employees of contravening laws and internal guidelines are unclear. Nor has CRG established a whistleblowing mechanism that allows all employees to give notice of acts of corruption anonymously and without any risk of subsequent sanctions. Such a whistleblowing procedure is internationally regarded as being a key anti-corruption measure and an important way to improve and further develop internal procedures so as to prevent future rule violations. Whistleblowing procedures appear to be becoming increasingly common in companies like CRG in China too.

In addition, it appears that the main elements of the company's anti-corruption procedures were established before 2011. The Council on Ethics notes that the prevailing measures have not prevented CRG from becoming involved in corruption cases. This indicates that the measures were not sufficiently suitable for preventing corruption. A few more elements seem to have been added, such as the rules for tenders referred to in the CRS reports for 2012 and 2013, but it is difficult to place particular emphasis on this when there is little indication that the compliance procedures were satisfactory to start with. Other Chinese companies in the same industry seem to place greater emphasis on good compliance systems. They state that they not only prioritise the implementation of extensive, targeted and efficient preventive measures but also believe it is important to show the world that they have such procedures.

The second element that contributes to future risk is that the company's management is to a large extent the same now as it was when the acts of corruption took place. The senior management on the board and in the group have held management positions since CRG was listed on the stock exchange in 2007 and many have had various management jobs within the company during these years. The Council also places emphasis on the fact that several members of the board and group management also held senior management positions in the parent company while the acts of corruption were taking place. The management's attitudes are generally regarded as being very important for preventing corruption. When no managers are replaced after a company has been involved in serious corruption cases, the Council believes that this sends a signal that the company is not taking the necessary measures to prevent future violations.

In addition, CRG's operations are in a sector that is known to be vulnerable to corruption. The building and construction industry, where large public contracts are common, exposes the company to a considerable risk of corruption. Although the risk of corruption in this sector has probably been reduced in China due to the measures implemented by the authorities, the company operates in a number of other countries with a considerable risk of corruption. For example, the CSR report for 2013 mentions that the company exports to, among other countries, Venezuela, Cambodia, Congo (DR) and Sierra Leone. According to Transparency International's *Corruption Perception Index* published in 2013, Venezuela and Cambodia are in joint 160th place out of 175 countries when it comes to the risk of corruption. Congo and Sierra Leone are ranked as number 119 and 116 respectively. The Council has noted that China adopted legislation prohibiting foreign bribery in 2011 and that this was expanded in 2013. However, good legislation is in itself not enough to prevent future rule violations. What is crucial is that the companies themselves have procedures to reveal corruption and prevent future breaches of the anti-corruption legislation. When CRG's compliance systems do not seem to meet the requirements normally stipulated for such systems, it is difficult to see that the risk of corruption has been significantly reduced.

In its overall assessment of the future risk, the Council also places emphasis on the fact that CRG has not replied to the Council's repeated requests. This weakens the basis for assessing the specific acts and compliance systems and increases the risk of future acts of corruption. In accordance with that stated in White Paper No. 20 (2008-2009), the Council on Ethics has in this case placed emphasis on the fact that *"lack of information on a company's conduct and, not least, the company's lack of willingness to provide information, can in itself contribute to the risk of participation in unethical conduct being regarded as unacceptably high."*⁵¹

In that CRG is involved in one of the most serious corruption cases in China, is still managed by the same people who managed it when the acts of corruption took place and who knew or ought to have known about the acts, and is still operating in countries heavily exposed to corruption without at the same time making it clear that it is trying to prevent future violations, the Council believes there is an unacceptable risk of CRG being involved in future cases of gross corruption.

8 Recommendation

The Council on Ethics recommends the exclusion of China Railway Group Ltd. from the investment universe of the Government Pension Fund Global due to the unacceptable risk of the company being responsible for gross corruption.

⁵¹ St. meld. Nr. 20 (2008-2009) (Report to the Storting (white paper)), page 125, text box 4.6, <http://www.regjeringen.no/pages/2172105/PDFS/STM200820090020000DDDPDFS.pdf>, refer also to the Council on Ethics' recommendation to exclude Zijin Mining Group Co. Ltd, 18 June 2012, available at http://www.regjeringen.no/pages/38494095/Tilr_Zijin_2012.pdf.

Ola Mestad
Chair

(Signature)

Dag Olav Hessen

(Signature)

Ylva Lindberg

(Signature)

Marianne Olsson

(Signature)

Bente Rathe

(Signature)