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The Council on Ethics' report to Norges Bank regarding its observation of Petróleo Brasileiro S.A.

In December 2015 The Council on Ethics recommended putting Petróleo Brasileiro SA (Petrobras) under observation due to the risk of gross corruption. Senior executives of the company and its most important suppliers had apparently for a decade organised a system of paying large bribes to top politicians, political parties and civil servants. Several of the company's senior executives also received large kickbacks. The Council did not believe that the company had proved it is effectively implementing its anti-corruption procedures, but nonetheless advised putting Petrobras under observation and not excluding it because the company's anti-corruption procedures were recently established. In addition, the extensive investigation in Brazil, the negative attention that the company had received both in Brazil and internationally and Brazil's new anti-corruption legislation all would reduce the risk of corruption reoccurring.

27 January 2016 Norges Bank decided to place Petrobras under observation and asked the Council on Ethics to monitor developments in this case. Throughout 2016, the Council has monitored how the company is working to develop and implement its anti-corruption programme. The Council has also observed how the company is dealing with investigations into past corruption, and has kept track of whether any new allegations of corruption have come to light.

The Council held meetings with Petrobras in October and December 2016 and in January 2017. The company has been given the opportunity to submit its comments on a draft of this report.

This is the Council's first annual report to Norges Bank with respect to this case.

Key events since the recommendation was made in December 2015

The investigation of the corruption cases connected to Petrobras got underway in Brazil in 2014, but has continued at full strength in 2015 and 2016. According to Brazil's prosecuting authority, a total of 57 indictments have so far been brought against 260 separate people in the Lava Jato case.¹ So far, more than 100 businessmen, agents and politicians have been convicted of corruption in a court of first instance, including six former senior Petrobras executives, out of which five have also admitted corruption and signed plea agreements.^{2, 3} Another three former employees are charged with corruption. A number of multinational companies that have been engaged as suppliers to Petrobras are also under investigation and some have signed plea agreements admitting to corruption.^{4, 5}

Petrobras has put the value of its losses from corruption at an estimated USD 2 billion. Brazil's federal prosecution service, the *Ministério Público Federal* (MPF), has estimated the actual total loss to be far higher.⁶

The MPF, Brazil's Auditor General (*Controladoria-Geral da União*) and the Federal Court of Accounts (*Tribunal de Contas da União*) will continue to investigate the Lava Jato case.

Petrobras is also under investigation for possible FCPA violations by the US *Department of Justice* (DoJ) and the *Securities and Exchange Commission* (SEC). The company has informed the Council on Ethics that its objective is to agree a settlement with the DoJ, but it remains uncertain when this may be possible.⁷

As a result of the corruption case in Brazil, legal proceedings have been brought against Petrobras in a New York court by a number of shareholders who are claiming damages for financial loss. In October 2016, Petrobras settled four separate lawsuits.⁸

According to information published in Brazilian and international media, Petrobras is also involved in cases of alleged corruption in several other countries, including Angola, Nigeria, Benin, Argentina and the USA. Several of these cases are under investigation in Brazil and the USA, but less information is available about them than the Lava Jato case.⁹

As stated in the Council's recommendation, Petrobras launched an internal inquiry in 2014, with the assistance of two external law firms. This inquiry is ongoing, though the company says it is uncertain when it will be concluded.¹⁰ In its dialogue with the Council on Ethics, Petrobras has underlined that it is allocating considerable resources to this inquiry, and that, in

¹ As stated on the MPF's website, <http://lavajato.mpf.mp.br/atuacao-na-1a-instancia/resultados/a-lava-jato-em-numeros-1>.

² O Globo, <http://especiais.g1.globo.com/politica/2015/lava-jato/condenados-da-lava-jato/>.

³ Email from Petrobras, 22 February 2017.

⁴ *Financial Times*, 15 February 2015, <http://www.ft.com/intl/cms/s/0/96152e80-b3ca-11e4-a6c1-00144feab7de.html>.

⁵ For instance Odebrecht, cf the American Department of Justice's webpage, <https://www.justice.gov/opa/pr/odebrecht-and-braskem-plead-guilty-and-agree-pay-least-35-billion-global-penalties-resolve>

⁶ *Financial Times*, 2 July 2015, <http://www.ft.com/intl/cms/s/0/3c937964-20d7-11e5-aa5a-398b2169cf79.html#axzz3kUSYdgpF>.

⁷ Meeting between the Council on Ethics and Petrobras, 10 October 2016.

⁸ Reuters, 21 October 2016.

⁹ See for instance BBC Brasil em Londres 10 mai 2016: http://www.bbc.com/portuguese/brasil/2016/05/160505_lavajato_exterior_tg.

¹⁰ Meetings between the Council on Ethics and Petrobras, 10 October 2016 and 4 January 2017.

2015 and 2016, it initiated in-house investigations into a number of other cases of alleged corruption that have come to light partly through its specialized and independent whistleblowing channel.

In 2015, an independent committee, called the *Special Committee*, was set up to act as a reporting channel between the external law firms in charge of the external inquiry and the company's board. The committee has been given a broad and multi-faceted mandate to ensure, among other things, that the role played by company executives in the alleged corruption is "*investigated comprehensively*", so that the company will conduct its business in strict compliance with the regulations, adopt good practice with respect to corporate governance and strengthen its capability to prepare accurate financial reports to the stock exchange authorities. Furthermore, the committee will ensure that the company cooperates with all relevant investigative bodies. The *Special Committee* has been granted complete access to any criminal proceedings currently underway or concluded. The committee will ensure that the external investigators have sufficient autonomy and resources. It will evaluate periodic reports to the board and prosecuting authorities, and will assess and approve the external investigators' recommendations.¹¹

Changes in the board and group management

In addition to the comprehensive replacement of board members in 2014, Petrobras has made changes to its board and group management in both 2015 and 2016. [REDACTED]

[REDACTED]¹² [REDACTED]
[REDACTED]¹³ In May 2016, Brazilian media reported that one of those convicted in connection with the Lava Jato case had told investigators that [REDACTED] had been key players in the corruption system. The two are supposed to have come up with the plan for the illegal donation of funds to the ruling Labour Party, and illegal contributions to [REDACTED] election campaign.¹⁴

The company's anti-corruption efforts since 2015

In its recommendation, the Council attached considerable importance to the fact that Petrobras had recently taken steps to establish an anti-corruption programme. The organisation of this compliance effort seemed to reflect international standards and best practice, and most of the initiatives were already in place in 2015. An independent anti-corruption department with sufficient authority and resources was established. The board also created the independent position of *Chief Governance, Risk and Compliance Officer (CGRCO)*. The incumbent of this position oversees the risk, corporate governance and compliance departments, and reports to the CEO, and in his capacity of a member of the *Special Committee*, to the board of Directors. He has veto rights over propositions of any other executive officer, and his contract can only be terminated with the agreement of a Board member appointed by the minority shareholders.

In 2016, the Council on Ethics met Petrobras's *CGRCO*, representatives of the *Compliance Area*, the legal affairs department, investor relations department, and the *Asset Manager* for Petrobras Nigeria (Upstream). In January 2017, the Council also held a meeting with a member of the *Special Committee*,¹⁵ as well as the *CGRCO* and representatives of the *Compliance department*.

¹¹ *Mandate and Charter of the Special Committee for the Internal Investigations of Petrobras*, 24 February 2015.

¹² Bloomberg, 27 March 2015, <https://tinyurl.com/replace-as-chairman>.

¹³ SEC filing Form 6-K May 30 2016, http://generate.api.edgar-online.com/EFX_dll/EdgarPro.dll?FetchFilingHTML1?SessionID=9GG6ezZedFjtG9_&ID=11417471.

¹⁴ Folha d S. Paulo May 8 2016, <https://tinyurl.com/bndes-donation>.

¹⁵ Dr. Andreas Pohlmann.

In its dialogue with the Council, the company has pointed out that its anti-corruption efforts have continued in 2016. Several changes have been made to the company's corporate governance model, including the way in which the board is appointed and organises its work. Qualification requirements, which also cover integrity and compliance, have been set with regard to board members. Furthermore, *CGRCO* now conducts thorough integrity inquiries into all board members and executives before they are appointed.¹⁶ The length of time for which board members are appointed and the rules governing their reappointment have also been altered. It is, moreover, no longer possible for one and the same person to act as board chair and CEO.

Petrobras also set up several new board subcommittees in 2015 to ensure better corporate governance and control. It is now clear that the board has ultimate responsibility for compliance.

The compliance department currently employs more than 200 people. It is divided into three subunits, "*Internal Controls*", "*Compliance and Integrity Program*", and "*Internal Investigations*". 45 people work with internal control, 110 work with the anti-corruption programme and 42 work with internal investigations.

The Council has received a number of internal documents, including the *Compliance Department Report* to the board, guidelines and procedures for the implementation of anti-corruption activities and the compliance department's *Compliance Plan*, which also sets out detailed plans for internal control and anti-corruption activities in 2017 and 2018.¹⁷ The Council on Ethics has also received a copy of the first set of recommendations made by the *Special Committee*, which the board approved in 2015, as well as a copy of a further set of recommendations from the *Special Committee* that were approved by the board in 2016. According to EY, which has been engaged by the board to monitor the implementation of the committee's recommendations, almost all of the first set of recommendations were implemented in 2015 and 2016.¹⁸ The company aims to implement the additional recommendations as soon as possible.

Other improvements that the company says were implemented in 2016 include the fact that corruption risk is now assessed by the compliance department in conjunction with the risk department, internal auditing and other relevant bodies. On the basis of the company's *Corporate Risk Management Policy*, which was approved by the board in 2015, the *Compliance Area* drew up its own internal procedure for defining guidelines for the management of risk relating to fraud, corruption and money laundering. The aim is to reduce the company's risk exposure and to help identify, assess, manage and monitor these risks. According to the company's *Compliance Plan*, efforts to identify and manage corruption risk will be further refined and implemented in 2017.

2016 also saw the development of specific training programmes for employees working in high-risk areas. During the year, face-to-face training has been given to employees working in procurement-related areas. The programme for classroom tuition will be further developed in 2017. On the basis of the feedback from employees, the existing online training programme, which has been taken by over 80 per cent of the group's entire workforce, will also be further developed in 2017. More time will be devoted to dilemma training and specific examples.

With regard to *integrity due diligence* on third parties, which also falls within the remit of the *Compliance department*, the company has introduced completely new procedures in 2016, which will be further refined in 2017.

¹⁶ Meeting between the Council on Ethics and Petrobras, 10 October 2016, and letter with attachments from Petrobras, 5 December 2016.

¹⁷ Letter to the Council on Ethics, with associated attachments, 5 December.

¹⁸ Summary of Status Report as of November 23, 2016, EY.

In its dialogue with the Council, the company has also pointed to the appointment of a new *General Ombudsman* in 2016. This individual will receive all notices of rule violations and report directly to the board of directors. The company believes that this scheme has already produced positive results, namely that concerns are reported and logged systematically, cases are investigated and anonymous notices are handled in confidence. According to the *Compliance Unit Activities Report*, this has resulted in the receipt of over 1,000 reports of corruption and fraud in the period January to September 2016. During that same period, 61 disciplinary measures were handed out and 13 initiatives instigated. Employees have subsequently been fired and contracts with suppliers terminated as a result of the facts brought to light by internal inquiries.

According to the company's *Compliance Plan* for 2016, the compliance department intends to establish a system to monitor the efficacy of the anti-corruption programme in 2017. Work on this began in the summer of 2016.

According to the representative of the *Special Committee* that the Council on Ethics has spoken to, Petrobras has cooperated with relevant investigative bodies. Over a period of two years, the company has devoted substantial resources to uncovering corruption and reporting its findings to the authorities in both Brazil and the USA.¹⁹ According to the *CGRCO*, the company has itself reported to the authorities several corruption cases that have been brought to light internally.²⁰ The *Special Committee* also considers that Petrobras has made many sweeping organisational changes, which will improve its internal controls. It also claims that much work has been done in both 2015 and 2016 to set up and implement an entirely new compliance programme. A number of relevant measures have already been implemented, while others will take some time to put in place. Although the Council on Ethics was told that Petrobras was "on the right track", it was also stated that the anti-corruption programme needed to be further developed and implemented in the coming years, and that the company must, in the longer term, assess its efficacy.²¹

However, it must be mentioned that in its dialogue with the company in 2016, it emerged that Petrobras was not fully implementing its anti-corruption programme in its international operations, for instance in that portion currently engaged in Nigeria. The company has maintained that it is working with BTG Pactual in a *joint venture* and that BTG also has responsibility for compliance. Furthermore, Petrobras has pointed out that its activity in Nigeria is insignificant, and that it is investing solely in projects there that Total and Chevron have operational responsibility for.²²

The Council's assessment

On the basis of the information which the Council on Ethics has received from Petrobras in 2016 and 2017, the Council deems the company to have substantiated that the anti-corruption efforts initiated in 2015 have continued in 2016, and that additional plans exist for the establishment and implementation of an effective anti-corruption programme. In particular, reference is made to the extensive written information that the Council received from Petrobras in December 2016, as well as the meeting with the *Special Committee* representative in January 2017. Access to information and documentation regarding measures the company has implemented has played an important role in the Council's decision to recommend continued observation rather than exclusion.

Nevertheless, the Council finds it challenging that the company maintains that it is merely the victim of the actions of individual former employees, and that the company as such is not

¹⁹ Telephone conference between the Council on Ethics, Dr Andreas Pohlmann and Petrobras, 4 January 2017.

²⁰ Meeting between the Council on Ethics and Petrobras, 10 October 2016.

²¹ Teleconference between the Council on Ethics, Dr Andreas Pohlmann and Petrobras, 4 January 2017.

²² Meetings between the Council on Ethics and Petrobras, 10 October 2016.

responsible for what has happened. Given that the company has been accorded the position of aggrieved party in the criminal cases in Brazil and that civil litigation continues in the USA, where the issue of the company's culpability is key, this attitude is understandable. At the same time, the Council points to the allegations that have recently emerged in the Brazilian press implying that the person [REDACTED] and a [REDACTED] may have played an important part in the corruption scheme. Furthermore, the Council is of the opinion that such an attitude on the part of management may discourage any changes in Petrobras's corporate culture and the effective implementation of the new anti-corruption programme.

The Council notes that, in 2016, the company made changes to its articles of association which have improved its corporate governance model. Nevertheless, it remains the case that only one of the company's nine board members is elected by the non-controlling shareholders. It is therefore plausible to assume that the company's ability to avoid once again becoming involved in acts of corruption will depend on the measures being implemented to combat political corruption in the country.

Nevertheless, the Council does not find that Petrobras should be excluded from the fund. This assessment rests on several factors. One key factor is that substantial resources continue to be allocated to the uncovering of corruption, both through the use of external law firms and internal resources. Moreover, the company appears to be cooperating with prosecuting authorities in Brazil and the USA, and to be reporting to the authorities on corruption cases which are uncovered internally. The Council also attaches importance to the board's appointment of and mandate to the *Special Committee* and the *CGRCO*. The committee seems to have been an important prerequisite for the effective undertaking of internal inquiries, for structural changes in the internal control system and for the development of a renewed anti-corruption programme. The committee has also made recommendations for further improvement of internal controls, which the Council presumes will be followed up in 2017.

However, several of the company's former employees and a number of suppliers are still under investigation for corruption, and several more related investigations have been opened since the Council on Ethics issued its recommendation in 2015. What is important for the Council moving forward will be how the company responds to these cases, and whether it continues to develop its anti-corruption programme effectively in 2017. The Council will also attach importance to whether management clearly communicates a zero tolerance for corruption in the company, and creates suitable incentives to achieve this aim. In this, as in similar cases, the Council takes the position that the onus is on Petrobras to substantiate that it is working effectively enough to prevent, uncover and respond to corruption in its organisation.

The Council on Ethics will continue to observe Petrobras's anti-corruption efforts through ongoing dialogue with the company. The Council will also watch out for any information regarding cases of gross corruption in the company which may emerge through other channels, and will monitor the company's response to these.

Yours faithfully,

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