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Report on the Council on Ethics' observation of Leonardo for 2018

In December 2016, the Council on Ethics recommended that Leonardo SpA be excluded from investment by the Government Pension Fund Global (GPF) due to the risk of gross corruption. The company had been involved in serious cases of corruption spanning the period 2009–2014 in four different countries. In all the corruption allegations, the company was accused of paying bribes to public officials through agents. In the Council's opinion, the company had not adequately substantiated that it had established targeted internal corruption-prevention procedures which were implemented effectively throughout the organisation. Leonardo's use of agents and how the company dealt with this risk were decisive for the Council.

On 5 May 2017, Norges Bank decided to place Leonardo under observation because it considered that the company's anti-corruption initiatives provided sufficient grounds to observe its development going forward. In 2018, the Council on Ethics has monitored the company's efforts to develop and implement its anti-corruption programme. The Council has also monitored whether new allegations of corruption have emerged.

The Council on Ethics met with Leonardo in April 2018. The company has subsequently also provided written answers to the questions the Council still had after the meeting and supplied a variety of documents. The company has also 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 on its observation of Leonardo.

Key events since the recommendation was made in December 2016

Allegations of corruption in India:

Shortly after the Council on Ethics had submitted its recommendation to Norges Bank, Italy's highest appeals court (*Corte di Cassazione*) quashed the convictions of Leonardo's former

chair and CEO and AgustaWestland's CEO, which had been pronounced in April of that year, due to procedural errors, and ordered a retrial.¹ In early January 2018, the pair were acquitted in the appeals court. The court was citing insufficient evidence as the reason for the decision.²

However, legal proceedings relating to the same case in India seem to be continuing apace. India's prosecuting authority, the Central Bureau of Investigation (CBI), had indicted a number of people, including Leonardo's former chair and CEO and Agusta Westland's CEO, as well as the companies Leonardo (Finmeccanica) and AgustaWestland, at the start of September 2017.³ When the Italian appeals court's verdict was pronounced in January 2018, representatives from the CBI made it clear that this judgment would have no impact on the investigation in India.⁴ In connection with the legal proceedings in India, representatives of AgustaWestland attended a court hearing in New Delhi at the end of May 2018.⁵

Allegations of corruption in Panama:

Leonardo's 2017 annual report states that one of its former sales directors was expected to be brought to trial in Rome.⁶

Allegations of corruption in Algeria:

According to Leonardo's 2017 annual report, the corruption charges against two former CEOs of AgustaWestland were dismissed by the court in Busto Arsizio in December 2017.⁷

New investigation in Indonesia linked to the procurement of an AgustaWestland helicopter by the military:

In May 2017, it emerged that Indonesia's Corruption Eradication Commission (*Komisi Pemberantasan Korupsi – KPK*) had launched an investigation into three employees of the Indonesian Air Force for possible corruption in connection with the procurement of an AW101 helicopter in February of that year.⁸ In July 2017, it emerged that the CEO of the company PT Diratama Jaya Mandiri (PT DJM) was also a suspect in the case. The company is alleged to have bought the helicopter from AgustaWestland for IDR 514 billion and sold it on to the Indonesian Air Force for IDR 738 billion, which represents a loss to the latter of IDR 224 billion (around NOK 127 million).⁹ In April 2018, the Indonesian Financial Transaction Reports and Analysis Centre (*Pusat Pelaporan dan Analisis Transaksi Keuangan – PPATK*) announced that it had identified suspicious transactions totalling IDR 340 billion (approx. NOK 192 million) from PT DJM to Singapore and the UK, which could be linked to the

¹ Reuters, 16 December 2016: <https://it.reuters.com/article/topNews/idITKBN1451SQ>.

² Reuters, 8 January 2016: *Italian court clears former Leonardo bosses in India corruption case*, <https://uk.reuters.com/article/uk-leonardo-india-corruption-trial/italian-court-clears-former-leonardo-bosses-in-india-corruption-case-idUKKBN1EX16M>.

³ Times of India, 1 September 2017: <https://timesofindia.indiatimes.com/india/chopper-scam-cbi-files-chargesheet-against-ex-iaf-chief-tyagi/articleshow/60325660.cms>; The Indian Express, 1 September 2017: <https://indianexpress.com/article/india/agustawestland-vvip-chopper-case-cbi-files-chargesheet-against-s-p-tyagi-others-iaf-chief-4824183/>.

⁴ Times of India, 8 January 2018: *No impact of Italy court ruling on our probe of AgustaWestland case: CBI*, <https://timesofindia.indiatimes.com/india/no-impact-of-italy-court-ruling-on-our-probe-of-agustawestland-case-cbi/articleshow/62419652.cms>.

⁵ Leonardo, 30 June 2018: Half-year financial report at 30 June 2018, p. 44.

⁶ Leonardo, 31 December 2017: Annual report at 31 December 2017 – Consolidated financial statements, p. 140.

⁷ Leonardo, 31 December 2017, p. 141.

⁸ JakartaGlobe, 27 May 2017: *TNI and KPK Announce Three Graft Suspects in Presidential Chopper Scandal*, <http://jakartaglobe.id/news/tni-kpk-announce-three-graft-suspects-presidential-chopper-scandal/>.

⁹ Okezone News, 16 June 2017: *KPK Tetapkan Direktur PT Diratama Jaya Mandiri Tersangka Korupsi Heli AW 101*, <https://news.okezone.com/read/2017/06/16/337/1718293/kpk-tetapkan-direktur-pt-diratama-jaya-mandiri-tersangka-korupsi-heli-aw-101>.

helicopter case.¹⁰ According to the knowledge of the Council, Leonardo has so far not been part of this investigation.

The company's anti-corruption efforts since 2016

Corporate governance:

Leonardo appointed a new CEO in May 2017. At the same board meeting in which the new CEO was appointed, the company's chair was given responsibility for overseeing its implementation of rules relating to integrity and the fight against corruption.¹¹

Compliance:

In the Council on Ethics' dialogue with Leonardo prior to its original recommendation, the company made it clear that its new management attached considerable importance to the "tone from the top" in connection with its anti-corruption efforts. At a meeting in April 2018, it was again underlined that senior management had a crucial role to play in the company's endeavours in this area. It was emphasised that not only does the company's chair head the Corruption Prevention Coordination and Consultation Board and has recently been given particular responsibility for overseeing the company's anti-corruption efforts, the CEO has repeatedly communicated to employees the importance of integrity and the company's "zero tolerance" for corruption. This has been done in several key forums, such as the Compliance Council, which was held in both 2016 and 2017.¹²

One of the most important structural changes that the company has made in recent years seems to be the transformation of Leonardo from an industrial conglomerate into an integrated enterprise ("One company") with effect from 1 January 2016. By bringing all the air, defence and security business areas together in one company with seven divisions, and by implementing new procedures and guidelines to ensure more holistic and coordinated control, the company believes that it has become easier for management to communicate a clear and uniform message to all parts of the organization – also in the area of anti-corruption.¹³

The most substantive change that the company seems to have implemented in the anti-corruption area is the creation of a dedicated Anti-Corruption Unit within the Legal, Corporate Affairs, Compliance, Criminal Law and Anti-Corruption Department. This unit is responsible for ensuring that the company complies with the new Anti-Bribery Management Systems standard – ISO 37001:2016. Leonardo was certified in accordance with this standard in July 2018.¹⁴ It is also tasked with maintaining a constant overview of relevant anti-corruption regulations and best practices, contributing to the necessary updating of the company's internal guidelines, monitoring the implementation of Leonardo's anti-corruption programme, providing support and assistance to both senior management and all other employees on this topic, and helping the Disclosure Committee to deal with reports of

¹⁰ The Jakarta Post, 19 April 2018: *Suspicious transfers to Singapore, UK linked to helicopter deal*, <http://www.thejakartapost.com/news/2018/04/19/suspicious-transfers-to-singapore-uk-linked-to-helicopter-deal.html>.

¹¹ Financial Times, 19 March 2017: <https://www.ft.com/content/86d1a562-0ca0-11e7-b030-768954394623>; Leonardo, 16 May 2017: *Leonardo: The Board of Directors appoints Alessandro Profumo Chief Executive Officer*, <http://www.leonardocompany.com/en/-/cdo-bod-profumo-ad-ceo>.

¹² Meeting with Leonardo, 16–17 April 2018.

¹³ Meeting with Leonardo, 16–17 April 2018.

¹⁴ Leonardo, 24 July 2018: *Leonardo is the 1st company among the top ten global players in the AD&S sector to obtain ISO 37001:2016 "Anti bribery management systems" certification*, <http://www.leonardocompany.com/en/-/leonardo-anti-bribery-anticorruzione-iso-37001>.

potential corruption. According to Leonardo, the new unit may report directly to the company's chair if needed.¹⁵

The Council on Ethics' recommendation pointed out that Leonardo had failed to document that it had routines in place to identify and assess the risk of corruption, which is a prerequisite in international standards and best practice. The company now says that, since 2016, it has performed an annual Enterprise Risk Management (ERM) process, led by the Risk Management Department. The ERM processes is intended to support all areas of the business to identify, assess and deal with all types of risk (strategic, financial, operational and compliance). Management has chosen to make corruption risk an integral part of this process, because it wants to assess all its risks as an interlinked whole.¹⁶ With regard to corruption risk, the most important contributors to the ERM process are the Business Compliance Unit, the Criminal Law, Ethics and Integrity Unit and the Anti-Corruption Unit (all three of which are part of the Legal, Corporate Affairs, Compliance, Criminal Law and Anti-Corruption Department), and the Group Internal Audit. In addition to these key units, the various departments and divisions also help to identify relevant risks and initiatives in this process. The Group Internal Audit Department plays a particular role in monitoring whether agreed initiatives are implemented within the stipulated deadlines. Leonardo also says that the Risk Management Department has been given an important role in supporting the Anti-Corruption Unit's efforts to identify, assess and follow-up corruption risk in accordance with ISO 37001.¹⁷ The Council on Ethics has requested further details of the most important findings and associated initiatives from a previous corruption risk assessment performed by the company. However, the company has failed to comply with this request.

The Council on Ethics' recommendation pointed out that Leonardo's use of agents probably represented the largest corruption risk by far. In this connection, the Council made it clear that it was difficult to give credence to the company's announced scaleback of its use of agents as long as no specific plans had been drawn up for when and how this reduction would be accomplished or what the final target would be. According to Leonardo, the objective of reducing the number of advisors/agents remains in place. The company now states that it has cut the number by around 30 per cent, ie from 280 to 195, from mid-2016 to the end of 2017.¹⁸

Financial incentive schemes and "insourcing" represent two key methods for reducing the use of agents still further. With respect to incentives, Leonardo reports that it conducted a pilot scheme in 2017 aimed at company sales managers involved in particularly at-risk tender processes. One of the programme's objectives was to reduce the use of commercial advisors and sales agents in connection with such processes. This was achieved by tying the size of their bonuses to how much of the budget was spent on advisors/agents. The less money spent on advisors/agents, the higher the bonus. Based on the pilot scheme, efforts are now underway to develop a new incentive system that will also strive to minimise the use of advisors/agents. To date, the main focus has been on the helicopter and aircraft divisions. The new system is scheduled for completion during the second half of 2018.¹⁹

In addition to the above-mentioned financial incentives, Leonardo plans to gradually replace external advisors/agents with its own country managers.²⁰ The company says that during the period 2018–2022 it plans to establish country offices in a total of 24 countries worldwide. 18 of the country offices will be set up in the period 2018–2019, while the remaining six will be opened in the period 2020–2022. Verification of the country offices' compliance will be

¹⁵ Letter from Leonardo dated 22 June 2018; E-mail from Leonardo 31 October 2018.

¹⁶ Meeting with Leonardo, 16–17 April 2018.

¹⁷ Letter from Leonardo dated 22 June 2018.

¹⁸ Meeting with Leonardo, 16–17 April 2018.

¹⁹ Meeting with Leonardo, 16–17 April 2018.

²⁰ Meeting with Leonardo, 16–17 April 2018.

carried out from the head offices, either by divisional compliance officers or employees of the Compliance Department. According to Leonardo, the country managers will receive specific anti-corruption training. The intention is that the country offices of the company's international subsidiaries will also undergo "tailored" training. The country managers will, moreover, be responsible for providing local employees with the necessary training in this area.²¹

In its recommendation, the Council on Ethics questioned whether Leonardo had performed adequate due diligence before entering into agreements with agents. The company now says that 35 employees in the Business Compliance Unit of the Legal, Corporate Affairs, Compliance, Criminal Law and Anti-Corruption Department work full-time on this kind of background checks. The identity of the real (beneficial) owner of the agent's company, whether the company is domiciled in a tax haven, whether it is a "PO Box company", whether it figures on any blacklists, whether it has been the subject of negative reporting in the media, and whether payments are to be made in other jurisdictions are some of the issues that must be investigated as part of the due diligence process.²²

Leonardo has also provided the Council on Ethics with a copy of its internal guidelines, applicable from January 2016, which set out in detail the company's due diligence requirements for sales consultants and agents. As far as the Council can see, these requirements seem largely in accordance with those demanded by international best practice for such inquiries. According to the company, 34 of 160 requests for contract approval were rejected in 2017. Of this 34, 3 were rejected due to the risk of possible corruption/bribery.²³ Both at the meeting in April and subsequently, the Council has received confirmation that Leonardo immediately cancelled the contract with two agents in two different Asian countries when it became known that they may be involved in corruption cases relating to the sale of the company's materiel. However, the Council does not know what kind of due diligence was performed *before* contracts were entered into with these two. Leonardo has also confirmed the identity of the beneficial owner of a company responsible for selling AW helicopters in Russia and the Commonwealth of Independent States, but has not provided any further details about what kind of other due diligence inquiries were performed on it in accordance with the above-mentioned guidelines. To obtain a better understanding of how Leonardo carried out its due diligence, the Council has asked to see a couple of anonymised examples of due diligence reports in which the corruption risk has been assessed. The company has declined to comply with this request.

In its recommendation, the Council on Ethics said it would have liked to see a holistic plan for Leonardo's employee anti-corruption training, including a description of who would be trained in what, by whom and how often. It also pointed out that the role played by the Compliance Department in this area seemed rather diffuse, that the training seemed to lack practice in resolving dilemmas based on specific examples, and that no training was offered to third-parties.

According to Leonardo, the People, Organization and Transformation Department (ie HR) continues to have overall responsibility for employee training. It is also pointed out that senior management and the divisions' compliance officers play a key role in the training of employees with regard to compliance and corruption risk. Members of the Legal, Corporate Affairs, Compliance, Criminal Law and Anti-Corruption Department also participate in this effort.²⁴

²¹ Letter from Leonardo dated 22 June 2018.

²² Meeting with Leonardo, 16–17 April 2018.

²³ Letter from Leonardo dated 22 June 2018.

²⁴ Meeting with Leonardo, 16–17 April 2018; letter from Leonardo dated 22 June 2018.

Leonardo reports that it is in the process of creating an entirely new anti-corruption training programme for all employees of the parent company and subsidiaries, as well as for the company's agents. The programme is scheduled to be ready in June 2019. According to the company, the programme is based on risk assessments, which means that efforts are being made to tailor different modules to the most important needs of the different target groups. The programme is also intended to contain elements of dilemma training/case studies.²⁵

In its recommendation, the Council on Ethics remarked how peculiar it was that employees had not, up to that point, reported any incidences of corruption – not least in view of the large number of employees and the company's risk profile. The company now says that up to December 2017 it had received a total of 75 reports since its reporting scheme was introduced in March 2015. However, only one of these reports related to corruption (the attempted bribery of an employee by a supplier). According to Leonardo, the supplier in question has been blacklisted and all contracts with this company have been terminated.²⁶

The company's guidelines for the reporting of suspected wrongdoing do not make it entirely clear that employees are also supposed to report all instances in which bribes are requested (solicited) by potential customers/intermediaries, in addition to bribery/attempted bribery of/by the company's own employees. According to Leonardo, however, the company is in the process of launching a new awareness campaign on whistleblowing.²⁷

The Council on Ethics' assessment

Based on the information that Leonardo has provided in 2018, the Council on Ethics considers that the company has, in several key areas, demonstrably improved its capacity to prevent, uncover and deal with corruption since observation commenced.

The most substantive initiative seems to be the creation of an anti-corruption unit that has been given particular responsibility for maintaining the company's anti-corruption programme, monitoring its implementation throughout the business and helping the rest of the organisation in this effort. Although it remains to be seen how important this unit will become in Leonardo's anti-corruption activities, it seems clear to the Council that the establishment of a dedicated anti-corruption unit fulfils one key requirement in international standards for best practice with respect to compliance.

The Council also notes that Leonardo has instituted an annual ERM process, in which corruption risk forms an integral part. In addition, the new anti-corruption unit has been given special responsibility for assessing whether the ISO 37001 requirements relating to the identification, assessment and follow-up of corruption risk have been met. However, the Council remains unclear about where corruption risk stands in the company's overarching risk management efforts, how such risk assessments are carried out in the company and how the division of labour between the risk management department and the new anti-corruption unit will work in this area. Given that Leonardo operates in a sector and in many countries in which the risk of corruption is high, the Council considers the identification of corruption risk and clear lines of accountability in this area to be very important.

Leonardo's use of agents remains perhaps its largest source of corruption risk. The Council on Ethics notes that the company has implemented several initiatives in the past couple of years to reduce the number of agents it employs. Although the company still makes relatively extensive use of agents, the Council considers that a 30 per cent reduction over 18 months, combined with incentive schemes and the establishment of many new country offices, must

²⁵ Meeting with Leonardo, 16–17 April 2018; E-mail from Leonardo 31 October 2018.

²⁶ Meeting with Leonardo, 16–17 April 2018.

²⁷ Meeting with Leonardo, 16–17 April 2018; E-mail from Leonardo 31 October 2018.

be taken as a signal that Leonardo wishes to decrease this risk. Based on available information, the Council understands that Leonardo devotes considerable resources to the performance of due diligence inquiries on agents and other third parties, and to their continuous follow-up. In the Council's view, the company also seems to have drawn up largely appropriate due diligence guidelines. Since the Council on Ethics has not been granted access to any such background checks, it is, however, impossible to make any further assessment of their quality.

According to Leonardo, the company has to date received only one report of corruption since its reporting scheme was introduced in March 2015. The Council still considers this to be rather strange in view of the large number of employees and the company's risk profile. Not least, the Council also finds it dubious that not a single instance of bribes being solicited from the company's employees has been reported, at the same time as the company operates in a number of countries which rank very low on international corruption indexes. This alone indicates that the company's anti-corruption endeavours have not yet been communicated adequately down through the organisation. At the same time the Council notes that Leonardo is in the process of launching a new awareness campaign on whistleblowing.

The Council on Ethics has not yet received sufficient documentation on Leonardo's anti-corruption training activities to make a more detailed assessment of whether they meet basic requirements and contain the elements naturally expected by best practice. At the same time, the Council has noted that the company is in the process of drawing up an entirely new anti-corruption training programme for all employees, which is scheduled to be completed during June 2019.

Viewing all these elements in concert, the Council considers that the risk of Leonardo once again becoming involved in serious cases of corruption is lower now than when it issued its original recommendation. At the same time, the Council feels that too little time has elapsed for it to assess the extent to which the measures implemented are sufficiently effective. Observation should therefore be continued for the time being.

The Council on Ethics will continue to observe Leonardo's anti-corruption efforts through dialogue with the company. The Council will also monitor whether new information emerges from other sources regarding the case in Indonesia or any other serious cases of corruption, and how the company responds to them.

Yours sincerely,

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Chair of the Council on Ethics