

COUNCIL ON ETHICS

THE GOVERNMENT PENSION FUND GLOBAL

To Norges Bank

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UNOFFICIAL ENGLISH TRANSLATION

Recommendation to discontinue observation of Petroleo Brasileiro SA

Summary

The Council on Ethics for the Government Pension Fund Global (GPF) recommends that Petroleo Brasileiro SA (Petrobras) be removed from the list of companies it has under observation. Petrobras has been under observation since 2016. The Council on Ethics recommended that Petrobras be placed under observation in 2015 after revelations that senior executives at the company and its most important suppliers had for a decade operated a system in which the payment of bribes was a prerequisite for winning contracts with Petrobras. Investigations into some of these cases remains ongoing.

Despite the risk inherent in the fact that the Brazilian government, as the controlling shareholder, appoints a majority of Petrobras's board members, the Council considers that the risk of corruption in the company has decreased. This assessment rests partly on the legal settlement entered into with the US Department of Justice which confirms that Petrobras has implemented wide-ranging improvement measures since the investigations commenced in 2014, and that it has undertaken to report on the further implementation of its compliance programme and internal control measures each year until 2021. The Council would also like to point out that Brazil's federal prosecution service and supreme court have officially defined Petrobras as a victim in the Lava Jato investigation, and that the company is therefore assisting the prosecuting authorities in many ongoing criminal proceedings.

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1 Introduction

In accordance with the Council on Ethics' recommendation of 21 December 2015, Norges Bank decided on 27 January 2016 to place Petrobras under observation due to the risk of gross corruption. At the same time, it asked the Council to monitor developments in the case. The Council has therefore followed what Petrobras has done to develop its anti-corruption system. The Council has also observed how the company is dealing with investigations into historic incidents of corruption, and kept track of whether new allegations of corruption have emerged.

As part of this effort, the Council on Ethics sent an observation report to Norges Bank in 2017 and 2018. The Council's contact with the company during the observation period, key events since 2018 that have a bearing on the assessment for 2019 and the latest developments in Petrobras's anti-corruption activities are summarised below.

2 Sources

In 2017, meetings were held between representatives of Petrobras and the Council on Ethics. In addition to these meetings, there has been written communication between the Council and the company on an annual basis. By means of information published by the Brazilian prosecuting authorities, the Council has also monitored developments in the various corruption cases in which Petrobras has been, and to some extent still is, involved. In this recommendation, the Council has also attached importance to information provided by the US Department of Justice.

3 Report for 2019

3.1 Key events since the previous annual report was issued in 2018

Investigations into corruption cases linked to Petrobras continued in 2019 as well. Since the company signed a legal settlement with the US authorities at the end of September 2018, the Brazilian authorities have launched six new phases in the Lava Jato investigation (phases 56 to 61), four of which involve Petrobras.¹

Phase 56 (*Operação Sem Fundos*): This phase commenced at the end of November 2018 and relates to cartel activity, bid rigging, bribery and overbilling in connection with construction of Petrobras's new headquarters in Salvador, Bahia. The contract was entered into in September 2011. In the second half of December 2018, the Brazilian prosecuting authorities indicted 42 people, including a former director and four former employees of Petrobras.²

Phase 57 (*Operação Sem Limites*): This phase commenced at the start of December 2018 and relates to bribes in connection with trading in various oil products from Petrobras in the period 2009 to 2014. Later that same month, on two separate occasions, the Brazilian prosecuting authorities indicted a total of 16 people, including several former Petrobras

¹ Letter from Petrobras to the Council on Ethics, 26 July 2019.

² Agência PF, 23 November 2018: *PF deflagra a 56ª fase da Operação Lava Jato*, <http://www.pf.gov.br/agencia/noticias/2018/11/pf-deflagra-a-56a-fase-da-operacao-lava-jato>; Letter from Petrobras, 26 July 2019.

employees, for corruption and money laundering in connection with oil trading transactions with, respectively, Trafigura and Vitol.³

Phase 59 (*Operação Quinto Ano*): This phase commenced at the end of January 2019 and relates to Transpetro, Petrobras's oil transportation and logistics subsidiary. Under investigation are allegations that bribes were paid to win a total of 36 contracts with the company, worth a total of BRL 682 million in the period 2008 to 2014. The Brazilian prosecuting authorities indicted five people in connection with the case at the beginning of March 2019, including Transpetro's former CEO.⁴

Phase 60 (*Operação Ad Infinitum*): This phase commenced in the second half of February 2019 and relates to the system that the company Odebrecht established between 2010 and 2011 to launder money that was used to bribe politicians and employees at, among others, Petrobras. According to Petrobras, none of the company's former employees have been indicted in connection with this case.⁵

3.2 The company's anti-corruption activities since 2018

Corporate governance:

There have been several changes in the composition of Petrobras's board of directors and executive board (group management team) since the previous observation report was compiled. A new chair and CEO were appointed in the first half of January 2019. Both of these were appointed by Petrobras's controlling shareholder, ie the Brazilian state.⁶ At the start of January 2019, the company's CEO replaced four other executive board members: The Chief Refining and Natural Gas Executive Officer, the Chief Technology and Production Development Executive Officer, the Chief Strategy, Organization and Management System Officer and the Chief Exploration and Production Executive Officer.⁷

The company itself reports that the Brazilian government's ability, through its control of the majority of board members, to select group executives, who in turn are responsible for the company's day-to-day operations, constitutes a risk. This issue is particularly relevant in the

³ Procuradoria da República no Paraná, 5 December 2018: *Lava Jato: 57ª fase investiga corrupção de gigantes do mercado internacional do petróleo*, <http://www.mpf.mp.br/pr/sala-de-imprensa/noticias-pr/lava-jato-57a-fase-investiga-corrupcao-de-gigantes-do-mercado-internacional-do-petroleo>; Letter from Petrobras, 26 July 2019.

⁴ Agência PF, 31 January 2019: *PF deflagra 59ª fase da Lava Jato para desarticular esquema de propinas*, <http://www.pf.gov.br/agencia/noticias/2019/01/pf-deflagra-59a-fase-da-lava-jato-para-desarticular-esquema-de-propinas>; Letter from Petrobras, 26 July 2019.

⁵ Agência PF, 19 February 2019: *PF deflagra 60ª Fase da Operação Lava Jato Operação – “Ad Infinitum”*, <http://www.pf.gov.br/agencia/noticias/2019/02/pf-deflagra-60a-fase-da-operacao-lava-jato-operacao-2013-201cad-infinitum201d>; Letter from Petrobras, 26 July 2019.

⁶ Petrobras, 13 December 2018: *Appointment of the new CEO*, <https://www.investidorpetrobras.com.br/enu/249/FatoRelevanteAprovacaoNovoPresidente131218Ingles.pdf>; Petrobras, 21 December 2018: *Election of Petrobras' new CEO and changes in the Administration*, <https://www.investidorpetrobras.com.br/enu/229/FatoRelevanteNovopresidentemudancaadmIngles.pdf>; Petrobras 14 January 2019: *Changes in Petrobras' Board of Directors*, <https://www.investidorpetrobras.com.br/enu/161/ComunicadoMudanasnoCAIngles.pdf>.

⁷ Petrobras 4 January 2019: *Changes in the Executive Board*, <https://www.investidorpetrobras.com.br/enu/186/ComunicadoMudancasnaDiretoriaExecutivaIngles.pdf>; Petrobras, 7 January 2019: *Change in Exploration and Production Executive Office*, <https://www.investidorpetrobras.com.br/enu/182/ComunicadoNovasMudancasDiretoriaIngles.pdf>;

wake of presidential and general elections in Brazil, which take place every four years.⁸ The personnel changes described above show that this is precisely what happened after the last elections. Since politicians' direct influence over the appointment of senior executives at state-owned companies has been a key element in several of the major corruption scandals that have hit Brazil in recent years, the Council on Ethics asked Petrobras a number of questions relating to these appointments.

Section 17 of the Brazilian law on state enterprises (*Lei Nº 13.303, de 30 de Junho de 2016*) requires board members and senior executives of wholly or partly owned state enterprises to have academic qualifications and professional experience relevant to their areas of responsibility in these companies. Since Petrobras's newly appointed chair has obtained all his training and work experience as a naval officer, the Council on Ethics has asked the company how this appointment could be in compliance with the above-mentioned legal provision. However, in its letter of reply, Petrobras failed to provide any specific reasoning, stating merely that this educational and professional background qualifies the person concerned to act as the company's chair in accordance with section 17.⁹

The Council on Ethics has also questioned why it was necessary to replace the CEO after only seven months, as well as four other executive board members, when none of them had completed their fixed term. Petrobras has failed to provide any specific explanation for this either, reiterating that all appointments have been carried out in accordance with the company's due diligence procedures and handled by the appropriate committee (the Appointment, Remuneration and Succession Committee). This also applies to the appointment of the new board chair.¹⁰

Compliance:

By the time it concluded at the end of October 2018, the internal investigation into allegations of corruption against Petrobras had resulted in a total of 82 recommendations. According to Petrobras, the status as at July 2019 was that 72 of the recommendations have been fully implemented, two were cancelled and eight are in the process of implementation. The Council on Ethics has asked for access to the list of recommendations, but Petrobras says that the information is not available to third parties, since it is protected by attorney-client privilege. In addition, it is information whose protection could be necessary with a view to future legal proceedings.¹¹

At the same time, Petrobras points to the fact that the US authorities, in the legal settlement of September 2018, has confirmed that the company had implemented wide-ranging improvement measures since the investigation began in 2014.¹² These include the following:

- All of those who were serving on Petrobras's board of directors or executive board when the corrupt practices linked to the company were first uncovered have subsequently been replaced.
- The company's compliance function has been strengthened through the creation of a dedicated Governance and Compliance Department, and given greater independence

⁸ Petrobras, Form 20-F 2018, 29 March 2019, p. 22, https://www.investidorpetrobras.com.br/enu/892/Form-20F-2018-Ingles_2.pdf.

⁹ Letter from Petrobras, 26 July 2019.

¹⁰ Letter from Petrobras, 26 July 2019.

¹¹ Letter from Petrobras, 26 July 2019.

¹² Letter from Petrobras, 26 July 2019; U.S. Department of Justice, Criminal Division, 26 September 2018: *Re: Petróleo Brasileiro S.A. – Petrobras*, s. 2, <https://www.justice.gov/opa/press-release/file/1096706/download>

by ensuring that this department's leader, the Chief Governance and Compliance Executive Officer can only be removed from office with the consent of board members representing one of the minority shareholders.

- New investment procedures require, inter alia, a larger number of decision-makers and the participation of representatives from the Governance and Compliance Department on investment committees.
- The company's systems and guidelines for handling reports of alleged wrongdoing and the way investigations are performed have been strengthened.
- Measures to prevent inappropriate political influence being exerted over the company's business operations, including new appointment and promotion procedures, have been introduced.
- Anti-corruption training at the company has been strengthened by means of compulsory compliance training for all employees, specialised training for employees responsible for procurements, and a separate anti-corruption training programme for members of the board and executive board.
- A separate committee has been set up to mete out disciplinary measures and administrative sanctions on employees who break the rules.
- Internal controls with respect to procurement, including the performance of due diligence checks on potential suppliers, have been strengthened.

In accordance with the terms of the legal settlement, Petrobras has also undertaken to report to the US authorities on the further implementation of the compliance programme and internal control measures described therein each year until 2021.¹³

As regards the latest investigative and legal proceedings relating to the Lava Jato investigation, Petrobras discloses that it is cooperating with the Brazilian prosecuting authorities in connection with phases 56 and 57 (*Operação Sem Fundos* and *Operação Sem Limites*, respectively), while Transpetro has offered its assistance to the prosecuting authorities in connection with Phase 59 (*Operação Quinto Ano*). In connection with Phase 57, Petrobras has also implemented several internal measures to follow up the relevant corruption allegations. This includes the immediate imposition of administrative sanctions on company employees who had been involved in the corrupt acts, the freezing of trading agreements with the companies involved and the creation of a dedicated audit and investigation team to identify the causes of the irregularities, with a view to implementing corrective measures.¹⁴

Since April 2017, Brazil's federal prosecuting service and supreme court have officially defined Petrobras as a victim in the Lava Jato investigation. As a result, Petrobras had, as at June 2019, assisted the Brazilian prosecuting authorities in connection with a total of 57 criminal proceedings.¹⁵

4 The Council on Ethics' assessment

In its observation reports for 2017 and 2018, the Council on Ethics concluded that Petrobras had substantiated that it was implementing and further developing the anti-corruption activities it started in 2015. This impression was again confirmed in 2019.

¹³ US Department of Justice, Criminal Division, 26 September 2018, C-1.

¹⁴ Letter from Petrobras, 26 July 2019.

¹⁵ Petrobras, Form 20-F 2018, 29. March 2019, F-19.

The Council also notes that the US Department of Justice, in connection with the legal settlement entered into in September 2018, have confirmed that Petrobras has implemented wide-ranging improvement measures since the investigation began in 2014, and that it has undertaken to report on the further implementation of its compliance programme and internal control measures each year until 2021. The Council would also like to point out that Brazil's federal prosecution service and supreme court have officially defined Petrobras as a victim in the Lava Jato investigation, and that the company is therefore assisting the prosecution authorities in many ongoing criminal proceedings. The Council has also noted that the company responded resolutely when Phase 57 of the Lava Jato investigation was launched.

At the same time, the Council wishes once again to point out the risk inherent in the fact that the Brazilian government, as the controlling shareholder, still appoints a majority of board members and thereby also the company's executive board. Politicians' direct influence over the appointment of senior executives at state-owned enterprises has been a key element in several of the major corruption scandals that have hit Brazil in recent years. Since the most recent elections in Brazil, many members of Petrobras's board and executive board have been replaced. In the Council's opinion, the company has failed to provide a good reason for the replacements, but has merely stated that the appointments have been subject to internal due diligence procedures and been handled in relevant fora. In the Council's view, this weakens the potential for corporate governance at Petrobras to be as professional as possible and does nothing to reduce the overall corruption risk at the company.

However, these risks are no different to those facing many other state-owned enterprises in the oil and gas sector. In the Council's opinion, the measures that Petrobras has implemented in recent years demonstrate a considerable willingness and capacity to prevent, uncover and deal with corruption. Through its cooperation with Brazilian and US prosecuting authorities, the company's anti-corruption efforts will also be followed up quite closely over the next few years. The effect of continued observation by the Council will therefore be limited.

The Council considers that further observation of the company should therefore be discontinued.

5 Recommendation

The Council on Ethics recommends that observation of Petroleo Brasileiro SA be discontinued.

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Chair

(Sign.)

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(Sign.)

Cecilie Hellestveit

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