

Norges Bank
PO Box 1179 Sentrum
0107 OSLO

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The Council on Ethics' 2019 observation report on Leonardo SpA

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 2019, 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 September 2019. Both before and after this meeting, the company has also provided written answers to the Council's questions and supplied a variety of documents.

This is the Council's second annual report to Norges Bank on its observation of Leonardo.

Key events since the previous observation report was published in 2018

Allegations of corruption in India:

At the end of May 2019, Italy's Supreme Court found the former chair and CEO of Leonardo and the CEO of AgustaWestland not guilty of offences in India.¹ The lawsuits relating to the same case that are taking place in India have yet to be concluded. In addition to the alleged corruption being investigated by the Central Bureau of Investigation (CBI), the Indian Enforcement Directorate (ED) is, in parallel proceedings, investigating allegations of money laundering. Several individuals and businesses have been indicted in the case, including Leonardo and AgustaWestland. Representatives of the latter company attended a court hearing in New Delhi at the end of May 2018. Since April 2018, Leonardo has been pursuing legal action through the Italian judicial system in an attempt to have any further summonses by the Indian authorities nullified on the grounds of double jeopardy. These petitions have so far been rejected by Italian courts, most recently at the start of July 2019.²

Other matters:

As far as the Council on Ethics is aware, investigations and legal proceedings relating to alleged corruption in the sale of an AW101 helicopter to the Indonesian Air Force and eight AW159 helicopters to the South Korean Navy have still not drawn to a close. The Council has not found any published information to the effect that Leonardo is encompassed by these investigations, and the company has disclosed that it has not so far been contacted by either the Indonesian or South Korean prosecuting authorities in this connection.³

The company's anti-corruption efforts since 2018

In its original recommendation of December 2016, the Council on Ethics highlighted the identification and assessment of corruption risk, anti-corruption training, the reporting of suspected wrongdoing and the use of agents as the most important risk factors for Leonardo. The Council has focused particularly on these areas in its observation of the company.

*Corruption risk assessments:*⁴

In its observation report for 2018, the Council remarked that it was still unclear what place corruption risk had in the company's overarching risk management work, how corruption risk assessments were carried out in practice within the company, or how the division of responsibilities and tasks between the Risk Management Unit (RMU) and the new Anti-Corruption Unit (ACU) would work in this respect.

Leonardo has now disclosed that since February 2019 it has initiated a separate process for the identification, assessment and follow-up of corruption risk. This Anti-Corruption Risk Assessment (ACRA) is an integrated part of the overarching risk identification process. The intention is that ACRA shall be performed annually.

The ACRA process has been developed jointly by the RMU and the ACU, and both units have allocated resources (16 and 5 individuals, respectively) through the entire process that has lasted until September 2019. The process has involved a total of 112 interviews with 164

¹ Reuters, 22 May 2019: Italy court acquits two ex-Leonardo bosses in India corruption case, <https://www.reuters.com/article/india-leonardo-helicopters-trial/update-1-italy-court-acquits-two-ex-leonardo-bosses-in-india-corruption-case-idUSL5N22Y5WJ>

² Meeting with Leonardo, 19 September 2019; Leonardo Half-Year Financial Report at 30 June 2019, p. 40-41, <https://www.leonardocompany.com/documents/20142/6631718/Half+year+financial+report+30+June+2019+Wi+th+opinion.pdf/62769248-3eb5-5409-ad57-d2e5a2e427af?t=1564749748824>.

³ Meeting with Leonardo, 19 September 2019.

⁴ Meeting with Leonardo, 19 September 2019; Letter from Leonardo to the Council on Ethics, dated 22 November 2019.

so-called ‘process owners’ and ‘risk owners’ in the various parts of the company, and has resulted in a prioritised list of 24 overarching corruption risk areas. The three most important are considered to be (i) the negotiation and framing of contracts, (ii) the handling of expenditures relating to gifts, hospitality and entertainment, and (iii) the handling of relations with public authorities. The company points to the updating of relevant procedures and training/information measures as the key remedial measures in this connection. The RMU and ACU are also responsible for the ongoing follow-up of these risk areas and for reporting.

However, the Council on Ethics has not received any detailed information about how the risk assessments are ‘tailored’ to the individual country in which the company has business operations, the business areas concerned and associated processes, and what it considers the most important control mechanisms. According to Leonardo, a specific tailoring at the country/business area level will be introduced starting from the next ACRA 2020.

*Anti-corruption training:*⁵

In its 2018 observation report, the Council on Ethics pointed out that it had not yet received sufficient documentation of Leonardo’s anti-corruption training activities to make a qualified assessment of whether they meet fundamental requirements and contain the elements that it would be natural to expect in relation to best practice. Over the past year, however, Leonardo has completed the process of designing new anti-corruption training programmes for all employees, managers and third parties. The training programmes for employees and third parties are online courses, developed in conjunction with the consulting firm TRACE. On Leonardo’s side, representatives for the ACU, Compliance and the People, Organization and Transformation Department have helped to adapt the programmes to the company’s risk profile. In addition to general information about corruption and how to combat it, including the company’s regulations and systems, the training programmes for employees and third parties also contains several specific cases drawn from different processes where the risk of corruption is deemed highest. So far, the courses are available in Italian and English, but there are plans to translate them into more languages in the future. At a meeting with the company, the Council was given a demonstration of the third parties course and had the opportunity to take a closer look at the content of the specific cases.

The plan is for all third parties (commercial advisors, sales agents and lobbyists) with valid contracts to have completed the online course by the end of 2019, while the employees are supposed to have completed the course by mid-2020. However, the Council has not received any information indicating that the company also plans to carry out even more bespoke training in the form of classroom tuition for selected business areas, processes and employees.

Managers working at head office, in the divisions, subsidiaries and representative offices, as well as ‘high-risk personnel’ would undergo training in connection with the annual Compliance Council in October. During these gatherings, a selection of participants – based on defined risk areas and their roles in the divisions – would also take part in realistic case simulations.

*Whistleblowing:*⁶

In its 2018 observation report, the Council on Ethics questioned the fact that not a single case of bribes being solicited of company employees had been reported since the whistleblowing service was established in March 2015. This was particularly remarkable since the company operates in a number of countries which score very badly on international corruption indexes.

⁵ Meeting with Leonardo, 19 September 2019. Leonardo was unable to share the actual training material with the Council on Ethics, on the grounds that this was copyright protected under its contract with TRACE.

⁶ Letter from Leonardo to the Council on Ethics, dated 21 June 2019; Meeting with Leonardo, 19 September 2019; Letter from Leonardo to the Council on Ethics, dated 22 November 2019.

The report also pointed out that the company's reporting guidelines did not make it clear that employees were also supposed to report all attempts to solicit bribes. However, with respect to this latter point, Leonardo has subsequently drawn the Council's attention to the fact that, in the description of the reporting scheme on the company's website, soliciting bribes is explicitly stated as grounds for reporting. The company further disclosed that this is also part of its campaign to raise employee awareness of the whistleblowing scheme. The campaign has been carried out as part of the company's new anti-corruption training programmes. Furthermore, Leonardo points out that a new online whistleblowing platform is going to be operational by December 2019. Along with the launch of this new platform, the company is also designing an information campaign and a dedicated online course for all the Group's employees.

In 2018, Leonardo received 68 whistleblowing reports, 24 of which related to cases of alleged corruption regarding the company's employees and third parties. The Group Internal Audit (GIA) investigated all of those 24 reports. At its meeting with Leonardo, the Council was given a run-through of how two of these reports had been investigated and dealt with by the company. GIA could not find any concrete evidence which confirmed the corruption allegations, but was able to verify other violations of its Code of Ethics, such as conflict of interests and breach of procurement procedures. In both cases, the outcome was the dismissal of those concerned. Furthermore, the company is in the process of terminating the contract with the supplier involved in one of the cases. Leonardo is also collaborating with the Italian public prosecutor which has initiated investigations of the two cases. According to Leonardo, the cases also have led to the improvement and reinforcement of relevant internal control measures throughout the organisation.

Within the company, the Management Audit & Whistleblowing Unit has operational responsibility for investigating reports received. The unit was created in 2015 with a staff of three. This was increased to six employees in 2018. On the whole, the unit's staff have a legal and financial background. In this connection, the company points out that it also draws on resources with investigative competence from the Security Department. The ACU is also involved in assessing tips on matters relating to its area of competence. The company also engages external investigative competence when required.

Use of agents:⁷

Leonardo's use of agents was also highlighted in the Council on Ethics' 2018 observation report as posing perhaps the greatest corruption risk in the company's business operations. At its meeting with the Council, the company confirmed that the goal of reducing the number of agents it uses remains in force. This also applies to the number of contracts, since several agents have more than one contract with the company. As at 30 June 2019, the company had a total of 209 contracts with 148 commercial advisors, sales agents, lobbyists, etc. The target is to reduce the number of third parties by 5 per cent by the end of the first quarter 2020 and a further 5 per cent by the end of the first quarter 2021. With respect to contracts, the corresponding targets are 10 per cent and 10 per cent. According to the company the most important tool for reducing these figures is still the establishment of new country offices or subsidiaries in important markets. In this connection, the company has confirmed that the objective, presented in 2018, of establishing country offices in a total of 24 countries worldwide by 2022, remains in force. So far, the company has established operational country offices or subsidiaries in six of these countries. In addition, the company is committed to renewal. Over the past two or three years, one-third of the third parties have therefore been replaced.

⁷ Letter from Leonardo to the Council on Ethics, dated 21 June 2019; Meeting with Leonardo, 19 September 2019; Letter from Leonardo to the Council on Ethics, dated 22 November 2019.

At the same time, Leonardo has made it clear that it is difficult to entirely eliminate the use of third parties. Many procurements are complex and substantial in scope, take several years and involve many different stakeholders on the client's side. The actual tender competition will often be the last phase in a lengthy process. The company must therefore work very hard to understand the client's needs. In several cases, this will require the use of external competence in the form of advisors and agents. This requirement is particularly prevalent in emerging markets, and has also increased as a result of the company's greater focus on sales outside Europe and within the civilian sector in the last couple of years.

Leonardo recognises that the use of third parties involves a not insignificant risk of corruption. The company therefore underlines that it devotes considerable resources to reducing this risk as much as possible. A key aspect of this work is the due diligence background checks that the Business Compliance unit of the Legal, Corporate Affairs, Compliance, Criminal Law and Anti-corruption Department carry out when contracts with third parties are entered into, and the ongoing monitoring of these third parties once an agreement has been signed. Leonardo points out that it introduced a new risk assessment methodology in connection with an update undertaken in October 2018 of the company's internal guidelines for such background checks. This includes several immutable requirements that must be met before a contract can be approved. For example, Leonardo must be able to confirm the identity of the true beneficial owner of the company with which a contract is due to be signed. Indirect, abnormal or non-transparent methods of payment or billing are also grounds for rejecting a third party. According to the updated guidelines, the Senior Compliance Officer (SCO) and the head of the ACU must now provide a written opinion in relation to contracts with third parties that are deemed to represent a 'high' risk. The release of the two opinions is a mandatory phase of the Due Diligence process, and the two documents must be taken into consideration in the assessment process. In case the Risk Analysis highlights a "Not Acceptable" risk, the Due Diligence process is stopped and the relevant contract cannot be signed. At its meeting with Leonardo, the Council on Ethics was also walked through the due diligence investigations that have been carried out and the documentation that has been obtained in connection with the conclusion of a specific agreement with a strategic commercial advisor.

The vast majority of third parties are sales promoters, who are compensated primarily by means of success fees. Since this type of fee is generally associated with a fairly high corruption risk, the company says it has implemented several preventive measures. Among the most important steps are thorough checks and strict documentation requirements to ensure as far as possible that the agent's demands for payment are legitimate. To make these checks easier, the fee is also normally paid out in several tranches along the way. Maximum limits on the fees payable have also been instituted – both in percentage terms and absolute amounts. The company has shared these thresholds with the Council. In addition to the background checks, Leonardo takes the view that the anti-corruption training that all third parties must undergo is also helping to reduce the risk of corruption.

*Leonardo's anti-corruption system and the role of the ACU:*⁸

In 2018 Leonardo undertook a major process to certify its anti-corruption system in accordance with the new ISO anti-corruption standard – ISO 37001:2016. Key to this effort has been the establishment of the ACU and the creation of a holistic framework for the company's anti-corruption efforts. This is reflected in the document entitled 'The anti-corruption system of Leonardo S.p.A.' (ACS), dated May 2018, of which the Council has received a copy. As far as the Council can see, this document contains largely the same elements as the ISO standard requires of a holistic anti-corruption system.

⁸ Letter from Leonardo to the Council on Ethics, dated 21 June 2019; Meeting with Leonardo, 19 September 2019.

The ACU was created in mid-June 2018 with a provisional staff of six. The unit's head has been recruited from another unit in the same department, while the five other members of staff have been recruited externally. Although these mainly have a legal background, one employee with risk management and investigative competence was recruited from a consulting company. The unit's primary purpose is to monitor the implementation of the company's anti-corruption system and coordinate anti-corruption activities at Leonardo. At the same time, it seems clear that the ACU also plays a more operative role in the areas of risk assessment, training, the handling of whistleblower reports and the performance of due diligence background checks. In this connection, Leonardo points out that in total around 50 people in the company are, one way or another, engaged in anti-corruption efforts, and that the ACU's staffing level cannot be seen in isolation from these other resources. The head of the ACU presents both the plan for the company's anti-corruption activities and reports on their implementation directly to Leonardo's board of directors. However, although the unit reports functionally to the Chair of the Supervisory Board, it reports administratively to the Group General Counsel.

The Council on Ethics' assessment

In 2016, the Council on Ethics recommended Leonardo's exclusion from investment by the Government Pension Fund Global (GPF) because the company had not substantiated that it was working effectively to prevent corruption, despite being involved in corruption investigations in several countries and despite the substantial corruption risk inherent in the business sectors and countries in which the company operates. The Council's starting point was therefore the ongoing corruption investigations, while its assessment of corruption risk related primarily to the company's compliance systems.

In its 2018 observation report, the Council concluded that Leonardo had substantiated improvements in several key areas of its capacity to prevent, detect and deal with corruption since observation commenced. This impression has again been confirmed in 2019.

In connection with its observations in 2018, the Council pointed out that it remains unclear what place corruption risk has in Leonardo's overarching risk management process, and how the company performs such risk assessments. The Council notes therefore that the company has now established a separate arrangement for the identification, assessment and follow-up of corruption risk, and will introduce a specific tailoring at the country/business area level in the risk assessments for 2020.

With regard to anti-corruption training, the Council notes that Leonardo has concluded the work started in 2018 to develop new anti-corruption training programmes for all employees, managers and third parties. The Council notes in particular that the company has tried to adapt the programmes to its particular risk profile, and that the programmes intended for employees and for specially selected individuals from the different divisions include cases and simulations. The Council also notes that Leonardo has now adopted deadlines for when all the different groups are supposed to have completed the respective training programmes. However, based on the parts of the course material the Council has seen, it still appears to be relatively generic. As with the risk assessments, some work remains to be done to tailor the training programmes to the different roles and types of risk exposure to be found in the company, in keeping with best practice.

The greatest corruption risk for Leonardo's business operations is still probably associated with the use of sales agents and other third parties to promote sales of the company's products. At the same time, the Council has gained the clear impression that the company has long been aware of this risk, and that it has also taken several important steps to reduce it. In the Council's view, the background checks and ongoing monitoring that the Business Compliance unit carries out on third parties constitute a key plank in this effort. The documentation obtained in connection with one such background check, which the Council

has seen, gives the impression that they are thorough. Furthermore, the Council notes that Leonardo has updated its internal guidelines for such investigations, with the result that it now has a structured framework for assessing the risk linked to third parties and several immutable requirements that must be met before a contract can be approved. Other important measures, in the Council's view, include Leonardo's plans for a further reduction in the number of third parties and contracts in the period to 2021, and the ongoing process of 'insourcing' through the establishment of country offices or subsidiaries in the most important markets.

The Council also has the impression that, over time, Leonardo has put in place a well-functioning arrangement for receiving, following up and responding to reports of suspected wrongdoing, including reports of possible corruption. Considering that the company operates in a number of countries that score badly in international corruption indexes, the scope of such reports still seems to be too limited to reflect the real situation.

In its 2018 observation report, the Council made it clear that the creation of a dedicated anti-corruption unit (ACU) within the company appeared to be one of the most substantial changes Leonardo had made to strengthen the company's anti-corruption efforts since observation commenced. However, it also pointed out that it remained to be seen how central the ACU would be to this effort. Through its dialogue with the company in 2019, the Council has gained the impression that the ACU has been given a key role in both coordinating Leonardo's anti-corruption efforts and acting as a link between the organisation and the board of directors on matters relating to this area. The creation of a separate ACS document also demonstrates that the company is taking a holistic approach to anti-corruption. At the same time, the Council considers there are grounds to question whether the unit is as independent as best practice requires, given that the head of the ACU was recruited internally from the department under which the unit sits organisationally, and that the unit reports administratively to the Group General Counsel.

As the presentation above shows, the Council on Ethics considers that there is still room for improvement in Leonardo's systems and routines for preventing and detecting corruption. At the same time, the Council has the impression that the company has taken significant steps to reinforce its anti-corruption activities in recent years, and that its board and management are also keen to continue strengthening and developing this effort. This impression has also been confirmed by the company's willingness to share information and cooperate with the Council's observation process.

Overall, therefore, the Council finds much in Leonardo's anti-corruption activities that points in the right direction. At the same time, many of the improvements are very recent. It is therefore too soon for the Council to assess what the company is doing to update and further develop the system as it gains in experience. Observation should therefore continue until further notice.

The Council on Ethics will continue to observe Leonardo's anti-corruption efforts through dialogue with the company. The Council will also monitor whether information emerges regarding new cases of gross corruption involving Leonardo, and how the company responds to them.

Yours sincerely,

Johan H. Andresen
Chair of the Council on Ethics