

Unofficial English Translation

To Norges Bank

23 August 2022

Recommendation to discontinue observation of Leonardo SpA

Summary

In May 2017, Leonardo SpA (Leonardo) was placed under observation due to the risk that the company was contributing to or was itself responsible for gross corruption. Norges Bank made this decision on the basis of a recommendation to exclude the company issued by the Council on Ethics in December 2016. The Council's recommendation rested on allegations of corruption linking the company to the bribery of public officials, via intermediaries, in India, South Korea, Algeria and Panama in the period 2009 to 2014. The Council considered that the company had not adequately substantiated that it had implemented targeted internal anti-corruption procedures. For the Council, the decisive factor was Leonardo's use of agents and how the company managed this risk.

Throughout the observation period, the Council has had the impression that Leonardo's efforts to prevent, detect and deal with corruption have steadily improved. The Council's assessment now is that the company seems to have put in place an anti-corruption system that, in most areas, aligns with internationally recognised recommendations.

Since the autumn of 2020, the Council has been aware that two former Leonardo employees have been implicated in a new corruption case in Italy. No information has so far emerged to indicate that the company is encompassed by the ongoing investigation. The Council does not consider it expedient to continue observing the company pending new information that casts a different light on the case in question in Italy.

The Council no longer considers the risk of gross corruption in the company's business operations to be unacceptable and recommends that observation of Leonardo be discontinued.

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1 Introduction

In May 2017, Norges Bank made public its decision to place Leonardo SpA¹ (Leonardo) under observation due to an unacceptable risk that the company was contributing to or was itself responsible for gross corruption. The Council on Ethics had recommended the company's exclusion from investment by Norway's Government Pension Fund Global (GPFG) in December 2016.²

Leonardo produces and sells equipment to the aviation, defence and security sectors. Its main business operations are located in Italy, the UK, the USA and Poland. The company employs approx. 50,000 people worldwide.³

At the close of 2021, the GPFG owned 1.17 per cent of Leonardo's shares, worth a total of NOK 426 million.⁴

1.1 Matters considered by the Council

Pursuant to section 5(7) of the Guidelines for Observation and Exclusion of companies from the Government Pension Fund Global, the Council on Ethics may, on the basis of new information received, recommend that Norges Bank revoke a decision to exclude a company or place it under observation.⁵

2 Background

The Council's original recommendation to exclude Leonardo from the GPFG rested on allegations of corruption linking the company to the bribery of public officials, via intermediaries, in India, South Korea, Algeria and Panama in the period 2009 to 2014. The Council considered that the company had not adequately substantiated that it had implemented targeted internal anti-corruption procedures. For the Council, the decisive factor was Leonardo's use of agents and how the company managed this risk.

Following Norges Bank's decision to place Leonardo under observation, the Council has monitored how the company has worked on and developed its anti-corruption system and kept abreast of whether new corruption allegations have emerged.

¹ Issuer ID: 128107

² The Council's recommendation from 2016 can be found here:
<https://files.nettsteder.regjeringen.no/wpuploads01/blogs.dir/275/files/2017/05/Leonardo-Tilr%C3%A5dning-ENG-2016.pdf>

³ Leonardo's Annual Report 2021
<https://www.leonardo.com/documents/15646808/16736384/Integrated+annual+report+2021.pdf/237514d8-e171-3e2f-c57d-c297f62c7320?t=1649761893131>.

⁴ <https://www.nbim.no/en/the-fund/investments/#/2021/investments/equities/2887/Leonardo%20SpA>

⁵ Guidelines for Observation and Exclusion from the Government Pension Fund Global:
<https://files.nettsteder.regjeringen.no/wpuploads01/sites/275/2021/11/Guidelines-for-Observation-and-Exclusion-GPFG-29-November-2021.pdf>

3 Key incidents since the company was placed under observation

Allegations of corruption in India, South Korea, Panama and Algeria

The most extensive corruption allegations related to a case in India, which was under investigation by Italian and Indian authorities for several years. At the end of May 2019, the Italian Supreme Court finally acquitted the former chair and CEO of Leonardo and the CEO of its former subsidiary AgustaWestland of these charges. At the same time, the legal proceedings against former employees of Leonardo and AgustaWestland, as well as the two companies themselves, continued in India.

With respect to the corruption allegations against the company in South Korea, Panama and Algeria which were included in its original recommendation, the Council is not aware that Leonardo, its subsidiaries or former employees are any longer the subject of investigations or legal proceedings relating to the matters concerned. Nor has Leonardo reported on this.

Allegations of corruption in Indonesia

Immediately after observation commenced in May 2017, the Council became aware that the Indonesian authorities had launched an investigation into alleged corruption linked to the procurement of a helicopter from AgustaWestland (the AW101) for the Indonesian Air Force in February 2017. One of the suspects in the case was the CEO of a company that had bought the helicopter from AgustaWestland and then resold it to the Indonesian Air Force. Leonardo's helicopter division (LH) also signed a sales agent contract with the suspect in November 2016, though the agreement did not cover AW101 helicopters.

As far as the Council is aware, the investigation and legal proceedings relating to this case have not concluded. However it understands that Leonardo is not part of the investigation.

Allegations of corruption in Italy

In the autumn of 2020, it became known in Italy that two former Leonardo employees had been accused of paying, and promising to pay, bribes to a former undersecretary at the Italian Ministry of Transport in return for services in two areas of interest to Leonardo as a company. The first service allegedly concerned facilitating the construction of an airport in Viterbo, Italy, while the second service is supposed to have involved exerting influence on who was to be responsible for the procurement of Vessel Traffic Service (VTS) systems for the Italian Coast Guard.

As far as the Council is aware, the investigation and legal proceedings relating to this case remain ongoing. According to Leonardo, the company as such is not under investigation and the Council has found no information to indicate otherwise.

4 The company's anti-corruption efforts since 2017

In its recommendation from December 2016, the Council emphasised the identification and assessment of corruption risk, anti-corruption training, the reporting of wrongdoing and the use of agents as the most significant risk factors for Leonardo. The Council has therefore focused particularly on these areas in its observation of the company. During the observation period, Leonardo has undergone a process to certify its anti-corruption system in accordance with the new ISO 37001:2016 – Anti-Bribery Management Systems standard. This has given the Council greater opportunity to assess the extent to which Leonardo takes a holistic approach to corruption risk.

Corruption risk assessments

In 2018, the company disclosed that it did not have a separate process for assessing corruption risk but that this was integrated into the company's annual Enterprise Risk Management (ERM) process. In 2019, however, Leonardo was able to disclose that the company had started working to develop a separate methodology and process to identify, assess and follow up corruption risk. In 2020, this methodology, the Anti-Corruption Risk Assessment (ACRA), was further developed and the Council also received a presentation of the company's risk assessment for a specific country.

Anti-corruption training

In its 2018 observation report, the Council pointed out that it had not received enough documentation on Leonardo's anti-corruption training programme to be able to assess whether it met basic requirements and contained the elements it was natural to expect in relation to best practice. In 2019, however, Leonardo completed the work it had commenced the year before to develop new anti-corruption training programmes for all employees, managers and associated third parties. That same year, the Council was also given a demonstration of an employee course and an opportunity to scrutinise the training materials. In its assessment, the Council noted in particular that the company had endeavoured to tailor the programmes to the company's risk profile and that the programmes included cases and simulations. With effect from 2020, Leonardo's employee anti-corruption training programme also became available on the company's e-learning platform and was made compulsory. In 2021, Leonardo introduced annual, anonymous surveys of all employees to gain an overview of the quality of the company's anti-corruption training and the extent to which employees are aware of the reporting system and the protection afforded to whistleblowers.

Reporting

Leonardo already had an operational reporting system in place when the Council's observation commenced in 2017. In its recommendation the previous year, the Council had noted that it was remarkable, given the large number of employees and the company's risk profile, that it had not at that time received any reports relating to possible cases of corruption. Since observation began, the Council has received updated, annual overviews of the whistleblowing reports Leonardo has received – including reports concerning possible corruption – whenever this has been requested.

In 2018, the Council pointed out that the company's guidelines lacked clarity with respect to the reporting of incidents involving the solicitation of bribes from potential customers/intermediaries in addition to bribes/offers of bribes from/to company employees. With effect from 2019, Leonardo began to disclose the number of reports concerning demands for bribes in its reporting.

In 2020, Leonardo revised its guidelines for dealing with whistleblowing reports to strengthen the protection afforded whistleblowers, clarify the roles of various internal control bodies and give the company's employees greater protection from false or malicious reports.

On two occasions, the Council has received a presentation of how Leonardo's internal auditing function has investigated different allegations of corruption, and how the company has handled the outcome of these investigations.

Use of agents

In both the original recommendation and subsequent observation reports, the Council has pointed out that the biggest risk of corruption in Leonardo's business operations relates to its use of sales agents and other third parties to promote the sale of company products. At the

same time, the Council has noted that Leonardo has taken several steps to reduce this risk through the observation period.

A key aspect of this effort has been the goal of reducing the number of agents and contacts by specified percentages within specified deadlines. In this connection, the most important measure has been the establishment of new country offices or subsidiaries in important markets. During the observation period, Leonardo has established around 20 such entities. In addition, the company has focused on reducing risk through renewal, i.e. the replacement of a considerable proportion of its agents.

Another important tool is the due diligence inquiries that Leonardo performs in connection with the conclusion of agreements with third parties and the continuous monitoring of these parties after an agreement has been signed. In 2019, Leonardo also introduced a new risk assessment methodology. This includes several unwaivable requirements that must be fulfilled and compulsory assessments that must be performed on “high-risk” third parties before a contract may be approved. The company has also introduced a maximum limit – both in percentage and monetary terms – on the fees payable to sales agents.

In 2020, Leonardo was also able to provide the Council with the number of third parties who had been rejected on the grounds of “red flags” identified during the company’s due diligence inquiries in 2018 and 2019.

In connection with the observation process, Leonardo permitted the Council to review the report from the due diligence inquiry into the company in question in Indonesia. However, this was rendered impossible due to the Covid-19 pandemic.

Leonardo’s anti-corruption system

In 2018, Leonardo underwent a major process to certify its anti-corruption system in accordance with the new ISO 37001:2016 – Anti-Bribery Management System standard. Fundamental to this work was the establishment of an internal Anti-Corruption Unit (ACU) and the creation of a comprehensive framework for the company’s anti-corruption measures.

Leonardo completed its first audit of the company’s implementation of ISO 37001 in 2020. The audit confirmed that all the processes examined were being implemented in accordance with the company’s internal control system and resulted in just four non-compulsory recommendations. The Council received an executive summary of this audit in 2021 and was also offered the opportunity to review the actual audit report. However, it has not been possible to do this either, due to pandemic restrictions.

5 The Council’s assessment

In 2016, the Council on Ethics recommended that Leonardo be excluded from investment by the GPFG because the company had failed to substantiate that it was working effectively to prevent corruption, despite being involved in corruption investigations in several countries and despite the significant corruption risk in the countries and business sectors in which it operated. The decision to place the company under observation was based on uncertainty with respect to future developments. The Council’s starting point was thus the ongoing investigations into alleged corruption, while the assessment of corruption risk was primarily linked to the company’s compliance systems.

In its observation reports for 2018 and 2019, the Council concluded that Leonardo had substantiated that its efforts to prevent, detect and deal with corruption had had a positive development since observation began. This impression was also confirmed in 2020.

At the start of the observation period, the Council remarked on the lack of a separate process to assess corruption risk in the company. This has now been established. The Council also notes that Leonardo has further developed its methodology so that it is now possible to perform risk analyses that are tailored to the individual country in which it operates.

The Council has the impression that Leonardo has done much with respect to the provision of anti-corruption training since the observation period commenced. The company has developed dedicated anti-corruption training programmes for all employees, managers and associated third parties, which are tailored to the company's risk profile and include cases and simulations. The Council also notes that the company's online courses are compulsory and available to all employees via the internal e-learning platform. This is now evaluated on an annual basis.

The Council has consistently pointed out that the biggest risk of corruption in Leonardo's business operations seems to be associated with its use of sales agents and other third parties. At the same time, the Council notes that the company has taken organisational and procedural steps to reduce this risk during the observation period. A key aspect of this work has been the goals to reduce the number of agents and contracts, and replace these with new country offices or subsidiaries in important markets. The Council also has the impression that Leonardo has fairly robust systems for risk assessment, due diligence inquiries and follow-up of third parties. That third parties are rejected on the grounds of "red flags" also gives an indication that these systems are effective.

Leonardo already had an operational system for reporting potential wrongdoing when the Council commenced its observations in 2017. During the observation period, the Council has requested data which confirms that the system also picks up on reports of possible corruption, including reports concerning the solicitation of bribes by customers/intermediaries. In due course, Leonardo was able to provide such data as well as several presentations of how the company has investigated various corruption allegations and handled the outcome thereof. Both aspects are important in order to give the Council reasonable assurance that Leonardo has a system capable of identifying and handling reports of possible corruption.

The Council also considers it positive that Leonardo has instituted a comprehensive anti-corruption framework through ISO 37001 certification during the observation period, and that these measures will now be audited on a regular basis.

By 2021, the Council's overall impression was that Leonardo had done a great deal to strengthen its endeavours to prevent, detect and deal with corruption since observation commenced in 2017. This impression was reinforced by the company's openness and willingness to share information through the observation process. In the past year, the Council has therefore focused primarily on the progress of the corruption case in Italy, since this could also have an impact on its assessment of the risk of corruption at the company going forward. Leonardo has consistently asserted that the company as such was not subject to investigation and after eighteen months, the Council has found no information to indicate otherwise.

Norges Bank decided to place Leonardo under observation due to uncertainty about future developments. In the Council's opinion, the company did not at that time have a functioning system to prevent and detect corrupt practices. Now, however, Leonardo seems to have put in place an anti-corruption system that in most areas aligns with internationally recognised recommendations. On this basis, the Council therefore considers that there are no longer grounds for deeming the risk of the company contributing to gross corruption in the future to be unacceptably high. Nor does the Council consider it expedient to continue observing the company pending new information that casts a different light on the case in question in Italy.

Should the Council nevertheless become aware that Leonardo may be linked directly to this case or any other new cases of gross corruption, this would undoubtedly constitute grounds to initiate a new assessment of the company.

6 Recommendation

The Council on Ethics considers that the risk of gross corruption in the company's operations no longer is unacceptable, and recommends that observation of Leonardo SpA be discontinued.

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