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Observation report for Hyundai Engineering & Construction

Hyundai Engineering & Construction Co Ltd (HDEC) was placed under observation in July 2021, due to an unacceptable risk that it was contributing to or was itself responsible for gross corruption. Norges Bank's decision accorded with the Council on Ethics' recommendation of April 2021. The Council's recommendation was based on the fact that HDEC, alone or through subsidiaries, could be linked to allegations or suspicions of corruption in three countries in the period 2008–2018. Furthermore, HDEC had been involved in 13 different bid rigging cases in the period 2005–2013. In the Council's opinion, HDEC had not taken the various allegations seriously enough. At the same time, the Council's review of the company's systems and procedures for the prevention and detection of corruption left the impression that much remained to be developed and implemented.

In 2022, the Council has monitored how the company is working to develop and implement its anti-corruption programme. The Council has also monitored whether new allegations of corruption have come to light.

The Council met with HDEC in June 2022. The company has subsequently also provided written answers to the Council's queries and shared various documents.

This is the Council's first report to Norges Bank on this matter.

Status in key cases

Modernisation project Banpo-Jugong in Seoul:

According to HDEC, a total of 99 people were charged by the South Korean prosecuting authorities in February 2021, in connection with the Banpo-Jugong project. In this case, the company was accused of bribing residents to win a contract for the modernisation of the apartment complex in question. Among the individuals charged are members of the association, employees of the PR agencies involved, and seven company employees. As regards the criminal investigation and legal proceedings related to this case, HDEC has informed the Council that the case is still pending at the court of first instance in South Korea.

HDEC has disclosed that it has, independently of how the criminal proceedings are progressing, implemented several measures to prevent any similar incident from happening again in the future. Key to this work is the implementation of new Compliance Guideline in Housing Reconstruction Project Marketing, which states inter alia that:

- (i) the company's Legal Affairs Team must perform a compliance review of sales and marketing campaigns before their implementation;
- (ii) all contracts with suppliers (PR agencies) must include clauses specifically addressing compliance;
- (iii) all those involved in sales and marketing activities on the part of the company and the PR agencies must undergo compliance training and must also sign a Compliance Statement.

Since it has not yet been determined whether any of the company's employees have done anything illegal in this case, HDEC has so far held off from implementing disciplinary measures against those involved. The company has not disclosed that it has carried out its own investigation into this case either.¹

Cirebon 2 project in Indonesia:

This project related to the construction of the coal-fired power station Cirebon 2 in West Java. HDEC is accused of having paid hundreds of thousands of US dollars in bribes to a local politician to prevent local protests against the construction of the power station from disrupting the building process. In August 2022, it emerged that the case remains under investigation by the Indonesian Corruption Eradication Commission (KPK).² As far as the Council is aware, the case has not yet been investigated by the authorities in South Korea.

According to HDEC, the allegations in Indonesia are an important reason why the company has, fairly recently, revised its anti-corruption guidelines, introduced compulsory training on this topic for company employees, and introduced procedures for due diligence inquiries when contracts with third parties are to be entered into. HDEC also claims to have undertaken its own investigation into the circumstances surrounding the payments concerned, but has not shared the resulting report with the Council.³

Arzev refinery in Algeria:

This case relates to the former subsidiary Hyundai Engineering Corp (HEC), which is accused of participating in the bribery of executives at Sonatrach – the Algerian state oil company – in order to win the contract for the upgrading of the Arzev refinery. HEC has informed HDEC that no new information relating to this case has emerged since 2016. The Council has asked to see the report from the inquiry that HEC carried out when the allegations were made public, but neither HDEC has access to HEC's internal documents such as this report, as it no longer is a controlling shareholder in HEC. Hence, neither HDEC has received the report in question.⁴

The company's anti-corruption activities since 2021

Tone from the top:

In its recommendation, the Council sought further tangible examples of steps that HDEC's CEO and Board Chair had taken to communicate zero tolerance of corruption to employees

¹ Letter from HDEC to the Council on Ethics, dated 6 September 2022; Letter from HDEC to the Council on Ethics, dated 11 January 2023.

² Berita Satu, 30 August 2022: *Bos Hyundai Engineering and Construction Segera Diadili atas Kasus Suap*, <https://www.beritasatu.com/news/970563/bos-hyundai-engineering-and-construction-segera-diadili-atas-kasus-suap>.

³ Letter from HDEC to the Council on Ethics, dated 6 September 2022.

⁴ Letter from HDEC to the Council on Ethics, dated 6 September 2022; Letter from HDEC to the Council on Ethics, dated 11 January 2023.

and third parties. At its meeting with the Council, HDEC presented a letter, which the company's CEO and Board Chair had sent to the workforce at the end of February 2022, as one of the most recent examples of the "tone from the top" in the company. In the letter, reference was made both to the company's recent ISO 37001 certification and to its zero tolerance for corruption. However, the pandemic has prevented management from holding "town hall meetings" or other similar events to communicate the zero-tolerance message to employees in the past couple of years.⁵

According to HDEC, management has not yet had to decline a contract because the risk identified through due diligence processes has been considered too high.⁶

Risk assessments:

In its recommendation, the Council pointed out that HDEC had not shared sufficient information about the processes and methods the company employs to identify and assess corruption risk in its operations, and that the available information indicated that the company's analyses in this area remained underdeveloped. At its meeting with the Council, however, HDEC disclosed that it has now established a process and guidelines to assess corruption risk. Within HDEC, it is the company's Compliance Support Team (CST) that is responsible for undertaking this process. The company has recently developed an overarching risk map for the various divisions.

This "map" is the result of a three-part process:

1. Surveys based on external sources, i.e. media reports, court judgments and measures implemented by public authorities;
2. Interviews with employees in key functions ("compliance ambassadors" from key functions, including marketing/promotion, procurement/outsourcing, project-site management, and management support);
3. A review of reported bribery-related cases.⁷

HDEC states that it has identified four main areas where corruption risk is deemed to be highest. Within these four main areas, the company has also identified the activities to which, in its view, corruption risk attaches. This includes activities considered to have an "above-average" risk. The company's internal auditing unit has drawn up several checklists to monitor these latter activities and, if necessary, implement corrective action. HDEC has shared some examples of these checklists with the Council.

HDEC states that it has not yet drawn up a more detailed risk map for the individual business areas and activities, or for the individual countries in which it operates, although the company plans to integrate more country-specific factors in its risk assessments further down the line. HDEC has also provided the Council with an example of a high-risk country where the CST helped to perform a country assessment before the company entered into a joint venture there in 2021. HDEC states that, independent of the more targeted risk analyses, it also subscribes to services that continuously monitor countries/companies/individuals with a view to sanctions, negative media reports, PEP risk, etc.⁸

Compliance organisation:

In its recommendation, the Council pointed out that it was unclear how far HDEC had come in allocating dedicated resources to its anti-corruption effort. At its meeting with the Council, therefore, HDEC gave an account of the company's compliance organisation. At board level, the newly established Corporate Governance & Transparent Management Committee plays a key role in the company's endeavours in this area, since it is responsible for reviewing and

⁵ Meeting with HDEC, 15 June 2022.

⁶ Letter from HDEC to the Council on Ethics, dated 6 September 2022.

⁷ Meeting with HDEC, 15 June 2022; Letter from HDEC to the Council on Ethics, dated 11 January 2023.

⁸ Meeting with HDEC, 15 June 2022; Letter from HDEC to the Council on Ethics, dated 6 September 2022.

approving the company's anti-corruption compliance initiatives and evaluating the compliance aspects of important transactions.

The company's Chief Compliance Manager is appointed by the Board of Directors and leads HDEC's Legal Affairs Group (LAG). The CST is the LAG's central compliance unit. It has a staff of 13, of whom three are licensed lawyers and eight have legal background. Among other things, the CST is responsible for designing the company's compliance measures, training the workforce, monitoring compliance and offering advice and guidance to employees on compliance-related issues. The CST also plays a key role in assessing corruption risk and performing due diligence assessments on third parties. Three lawyers in the CST focus particularly on the anti-corruption area. Three CST employees have also undergone audit training in relation to the ISO 37001:2016 anti-bribery management systems standard.

To support the CST's compliance activities in the wider organisation, HDEC has also created the positions "senior ambassador" and "junior ambassador" in the various business areas. The primary function of these "ambassadors" is both to communicate HDEC's compliance-related rules and guidelines to the rest of the workforce, and monitor business activities within their areas of responsibility. According to HDEC, the company now has 25 senior ambassadors and 384 junior ambassadors. To become a senior ambassador, the employee must, at least, hold a senior management position and preferably have more than ten years' work experience. The company's goal is to increase the number of senior ambassadors.⁹

Training:

While working on its recommendation, the Council asked to see a more detailed plan for HDEC's anti-corruption training, use of specific cases in the company's training materials, as well as an external evaluation of the training given. At its meeting with the Council, HDEC stated that anti-corruption training continues to focus heavily on relevant laws and regulations covering the area – both national and international (including the USA's Foreign Corrupt Practices Act (FCPA) and the UK's Bribery Act (UKBA)) – as well as the company's anti-bribery management system. The course has a duration of two hours and is provided to the entire workforce of HDEC (all directors, officers and employees). The company itself considers that the training has little impact if it is too general, and it has therefore attempted to operationalise corruption risk further, e.g. in the various stages of the building process. In contrast to previously, certain cases have now been included in the training materials. The most recent FCPA and UKBA-related training materials which HDEC has shared with the Council refer to three tangible cases.

Furthermore, HDEC also carries out more specialised training in the performance of third-party due diligence assessments for its senior and junior ambassadors in the company's most exposed business divisions.

At present, the training may be undertaken only online. In any case, classroom tuition has been out of the question until now due to the pandemic. Once completed, it is possible to provide feedback on the eLearning course, but this is voluntary. So far, no "examination" has been introduced to test how well the employees have actually internalised the knowledge that the course is intended to convey.

HDEC states that the CST is also planning to have developed anti-corruption training courses for managers and employees in the company's international departments by the close of the second quarter 2023. The objective is for the training to be "tailored" as closely as possible to the local situation and legal framework.¹⁰

⁹ Meeting with HDEC, 15 June 2022; Letter from HDEC to the Council on Ethics, dated 6 September 2022; Letter from HDEC to the Council on Ethics, dated 11 January 2023.

¹⁰ Meeting with HDEC, 15 June 2022; Letter from HDEC to the Council on Ethics, dated 6 September 2022; Letter from HDEC to the Council on Ethics, dated 11 January 2023.

Third-party due diligence:

In its recommendation, the Council pointed out that HDEC had not yet implemented guidelines for third-party due diligence. At its meeting with the Council, HDEC confirmed that its due diligence systems were not previously good enough. Although the company's guidelines for due diligence assessments were adopted in 2019, the procedures for actually carrying them out were not implemented fully until the latter part of 2021. At present, due diligence assessments are directed solely at potential subcontractors and partners in joint ventures/consortia – not public authorities or multilateral development banks which announce major procurement projects. HDEC states that due diligence assessments are not performed on public authorities and development banks because the company does not control these counterparties, and does not have sufficient influence to require them to answer due diligence questionnaires. According to HDEC, public authorities and multi-national development banks like the World Bank are usually subject to even more strict laws and regulations, and codes of conduct to ensure their own integrity. HDEC therefore believes that there is a lower bribery risk associated with these parties than other third parties.

Background checks of subcontractors, including agents, are undertaken by means of a so-called “simplified” process, whereby potential subcontractors answer a relatively simple online questionnaire. Based on the answers given, certain contracts are referred onward to the CST for further review. For instance, connections between the subcontractor in question and public authorities will qualify for further due diligence and inquiries by the CST. HDEC has also stated that the use of agents is far less common in connection with major construction projects than, for example, in the defence sector. According to HDEC, certain countries in the Middle East require foreign companies to operate through local business partners, who then act as “commercial agents”. HDEC discloses that it currently has contracts with three such agents.

According to HDEC, partners in joint ventures and consortia must undergo a “standard” background check. This requires them to complete a more extensive questionnaire. The responsible person within the business area concerned, denominated the Authorised Person (AP), must also carry out their own investigations and verify the answers to the questionnaire. Key tools in this connection are Google, news searches and international sanctions lists. HDEC has not confirmed that the APs also use dedicated due diligence databases, but has disclosed that they are at liberty to consult and receive guidance from those responsible for due diligence assessments in the CST, when needed. If the AP uncovers one or more red flags in connection with their review, the contract must in any case be referred onward to the CST, which will assess whether mitigating measures are possible, or whether the contract should be declined. At present, three CST employees work with this kind of assessment. HDEC has not shared the updated version of its due diligence guidelines with the Council. However, the Council has received a copy of the questionnaires that are sent to third parties in connection with both the simplified and standard processes.

HDEC has also given the Council an account of the due diligence assessments it has carried out since the system became operational at the start of 2022. The account included the number of “standard” background checks performed on potential business partners, including the number which raised red flags. As at June 2022, no potential partners had been rejected on the basis of these assessments. Furthermore, HDEC has disclosed the number of registered subcontractors which have completed the simplified questionnaire and the number which raised red flags. As at June 2022, no entities had been rejected here either.¹¹

Whistleblowing and investigations:

In its recommendation, the Council noted that HDEC had had a whistleblowing system and procedures in place for a long time, but that it was difficult to form a picture of how well the

¹¹ Meeting with HDEC, 15 June 2022; Letter from HDEC to the Council on Ethics, dated 6 September 2022; Letter from HDEC to the Council on Ethics, dated 11 January 2023.

system works in practice, since the Council had not received any detailed information about the number of reports relating to bribery that had been received nor how these had been handled. The Council also questioned whether the sanctions imposed by the company on employees in connection with previous violations of the law were effective enough.

At its meeting with the Council, HDEC ran through the process from the moment a whistleblowing report is received until disciplinary action is, potentially, taken. The company confirmed that there is no established procedure for reporting directly to the Board of Directors. According to HDEC, management would not have known if anyone had nevertheless attempted to report concerns directly to the Board.

HDEC also presented statistics for the number of reports received in 2021 and how these were dealt with. This included the total number of reports received. Eight of the confirmed reports related to corruption (receipt of improper benefits, abuse of position). In those cases where internal guidelines were found to have been violated, disciplinary action was taken against 12 employees. The company's response was said to be severe in 10 instances.

At the meeting, HDEC also presented two cases that had been dealt with by the company's investigation team in 2021. HDEC stated that it is normal practice for the internal auditing unit to prepare a "lessons learned" memo after such investigations have been completed. This memo is then *inter alia* sent to the people working with sanctions within the company.

HDEC also has a separate guide to the performance of internal investigations, but deems this to be too confidential to allow it to be shared with the Council.¹²

ISO 37001 certification:

At its meeting with the Council, HDEC explained the process leading up to ISO 37001 certification. The certification body in this instance was Lloyd's Register, whose review of the company's compliance systems turned up only two non-conformances in relation to the standard. These were classified as minor. One non-conformance related to the fact that HDEC had not yet fully implemented a third party due diligence system in the company, while the other related to the individual business units not yet having established clear objectives for their anti-corruption efforts. The review also showed that there were still some areas with potential for improvement, such as the "zero tolerance" statement from the CEO, integrity agreements with business partners, additional resources for the internal audit unit and more specifically tailored anti-corruption training. HDEC has shared a brief summary of the certification body's report with the Council.

HDEC's anti-corruption system will be subjected to annual reviews, and a new full (external) audit will be undertaken when certification comes up for renewal after three years. HDEC's internal auditors are responsible for performing the annual, internal reviews. Since internal audit has hitherto had only relatively limited resources for this aspect, the company is now working systematically to train its anti-corruption ambassadors in internal auditing procedures. To date, 17 such ambassadors have been certified as internal auditors.¹³

Corporate governance:

In its recommendation, the Council pointed out that HDEC's corporate governance is weakened by having the same person perform the roles of both CEO and Board Chair. The Council questioned the efficacy of this with respect to preventing corruption in the company's operations. In HDEC's view, this is counterbalanced by the fact that the CEO can not hold "majority interest" in the company, that a majority of board members are external (four non-executive and three executive directors), and that the Board's Audit Committee is made up of

¹² Meeting with HDEC, 15 June 2022; Letter from HDEC to the Council on Ethics, dated 6 September 2022.

¹³ Meeting with HDEC, 15 June 2022; Letter from HDEC to the Council on Ethics, dated 6 September 2022.

non-executive directors.¹⁴ Hence, it is still the case that the same person continues to act as both CEO and Board Chair.

Anti-corruption enforcement in South Korea:

At the end of April and beginning of May 2022, South Korea's national assembly passed extensive amendments to the country's Prosecution Service Act and Criminal Procedure Act. Two months later, in July 2022, the OECD publicly expressed its grave concerns. This is because the OECD Working Group on Bribery considers that the amendments will severely restrict the prosecuting authorities' ability to investigate and prosecute cases of bribery that has taken place abroad. The South Korean government has asked the country's constitutional court to perform a judicial review of the amendments.¹⁵

In its most recent survey of anti-corruption enforcement in OECD countries, Transparency International (TI) still ranks South Korea in the lowest category, ie "little or no enforcement". According to the TI report, there are still weaknesses in the legislation covering this area, while enforcement is weakened by inadequate resources and political interference, among other things.¹⁶

Other issues:

During its observations, the Council has also become aware that HDEC may be linked to numerous work-related accidents in connection with projects for which the company is responsible. The Council has therefore asked HDEC to provide an overview of the number of employees in the company and at its subcontractors who have died or been the victims of accidents in connection with the company's projects in the past five years. This overview shows that the number of accidents relating to HDEC's projects is lower than average for the construction industry in South Korea. Most of the accidents have affected employees of HDEC's subcontractors. At the same time, the number of accidents, including fatal accidents, has not fallen during this period.

The Council has also requested an overview of the kinds of reactions/sanctions that have been imposed on the company and/or the company's employees during the same five-year period as a result of the violation of relevant HSE legislation, as well as the measures HDEC has implemented to prevent similar incidents in the future. According to HDEC, there have been two incidents for which the company or its employees have been found guilty of offences against South Korea's Occupational Safety and Health Act in the past five years. All told, HDEC and those employees involved have been fined KRW 27 million (approx. NOK 200,000) for these offences.

HDEC has underlined that HSE has a very high priority in the company and that it has a zero vision with respect to fatal accidents. The following are among the most important preventive initiatives HDEC has highlighted:

- Safety has become an integrated part of the company's corporate governance. A separate safety management division has been established under the leadership of a Chief Safety Officer (CSO). The CSO is also a member of HDEC's Board of Directors.
- HDEC has established a dedicated safety management system, with long-term goals, strategies, guidelines, organisation and training, etc. A key aspect of this is a range of incentive schemes that also apply to the company's senior executives.

¹⁴ Meeting with HDEC, 15 June 2022; Letter from HDEC to the Council on Ethics, dated 6 September 2022.

¹⁵ OECD, 20 July 2022: *Recent legislative reforms raise serious concerns over Korea's capacity to investigate and prosecute foreign bribery*, <https://www.oecd.org/daf/anti-bribery/recent-legislative-reforms-raise-serious-concerns-over-koreas-capacity-to-investigate-and-prosecute-foreign-bribery.htm>.

¹⁶ Transparency International, 2022. *Exporting Corruption 2022*, p. 77-79, <https://www.transparency.org/en/publications/exporting-corruption-2022>.

- HDEC performs a large number of HSE inspections every year. In 2021, more than 1,000 such inspections were carried out at the company's projects in South Korea. Both the CEO and CSO participated in several of these. In 2022, the company carried out inspections on all its building sites. In addition to its own inspections, inspections are carried out by third parties.
- In December 2019, HDEC was certified in accordance with the ISO 45001:2018 standard for occupational health and safety management systems.

The Council has not assessed these matters, as the company currently is under observation under the gross corruption or other serious financial crime criterion.

The Council's assessment

Based on the information that it has received from HDEC in 2022, the Council considers that the company has substantiated that, in several key areas, it has improved its capacity to prevent, detect and deal with corruption since the recommendation was made.

One of HDEC's most important initiatives seems to be the establishment of a process and guidelines for the assessment of corruption risk in the company's operations, and that the company has, as a result, recently developed an overarching risk map for the entire enterprise. At the same time, the Council notes that work remains to be done to draw up a more detailed risk map for the individual business areas and the countries in which the company operates.

The Council also notes that, with effect from 2022, HDEC has started performing more regular third-party due diligence assessments. Furthermore, the fact that HDEC can now also disclose how many of the company's potential business partners and subcontractors raise red flags gives an indication that its third-party due diligence systems are operational.

Nevertheless, the Council holds the view that there is a potential for further strengthening of HDEC's due diligence work. Although HDEC participates largely in tender processes that are, in principle, open and with competition between bidders, the Council questions the company's decision not to carry out due diligence assessments on public authority clients and initially only performing simplified inquiries of subcontractors. In the Council's view, vigilance with respect to potentially corrupt ties between public authorities and the company's subcontractors would be natural, not least in high-risk countries. This applies not only when the subcontractors are acting as agents, but also when they supply other goods or services. The Council understands that it can be both difficult and inexpedient to require public authorities to answer due diligence questionnaires. At the same time, however, the Council would like to point out that relevant information for such inquiries can be gathered in more ways than just through questionnaires. More generally, the Council would also like to point out that without access to HDEC's prevailing guidelines for due diligence, it is impossible for the Council to make any more specific assessment of whether these align with international best practice in the field.

The Council has the impression that HDEC's anti-corruption training arrangements have also been further developed since it made its recommendation. The Council would particularly like to highlight that the company has now introduced specialised training in the performance of due diligence assessments in its most exposed business divisions. That HDEC plans to develop tailored anti-corruption courses for managers and employees in the company's departments abroad is also a positive step in the right direction. The Council has, moreover, noted that training materials now contain references to specific cases. It nevertheless remains to be seen how tailored the training is to the different roles and positions within the company. The Council also questions whether it is possible to assess the efficacy of the training programme and, if necessary, make improvements, as long as there are no compulsory evaluations or tests.

In the Council's view, it is also positive that HDEC has undergone ISO 37001 certification, since a certification process of this kind could contribute to both uncovering deficiencies in

and establishing a more holistic framework for the company's anti-corruption measures. At the same time, the Council would like to point out that it is not possible to make any more detailed assessment of the basis for certification without access to the full report on which it is based.

The Council notes that HDEC believes it has board-level mechanisms in place that are adequate for exercising necessary control of the company's day-to-day management, even though the same person acts as both CEO and Board Chair. The Council notes that this is still normal practice among listed companies in South Korea, but nevertheless maintains that this is a weak point. Many of the corruption cases which the Council investigates involve the company's senior management. The Council therefore takes the view that it is more difficult for a board to exercise an independent control function with respect to corruption if the company's top management is not only represented on, but also chairs, the same board that is set to control it. In the Council's opinion, this could also weaken the purpose of having a mechanism for direct whistleblowing to the board.

External control of the company in the area of corruption could be further weakened if the responsible authorities fail to give it adequate priority. In this connection, the Council notes that South Korea still does not seem to investigate and prosecute corruption cases with any vigour and that the country's sentencing framework still seems to be too low.

Nevertheless, when the Council considers all the above-mentioned elements as a whole, its assessment is that the risk of HDEC becoming involved in gross corruption once again is lower now than when the recommendation to place the company under observation was originally made. At the same time, the Council considers that too short a time has elapsed to assess whether the measures implemented are sufficiently effective. Observation should therefore be continued until further notice.

The Council will continue to observe HDEC's anti-corruption activities through dialogue with the company. The Council will also monitor whether any new allegations of gross corruption are made against the company, and how the company responds in that case.

Yours sincerely,

Johan H. Andresen
Chair of the Council on Ethics