

Business Ethics

ESG

Sustainability Research

Corruption indices: From disclosure to risk exposure



Sustainability Research

A new forward-looking indicator to assess risk exposure to corruption:
We build on the Transparency International (TI) methodology to develop a new tool for investors that rates companies on their risk exposures to corruption. Using forward-looking indicators in the context of business exposure and news flow, our rating aims at mitigating increasingly material corruption risk and enabling engagement.

Sector risks emphasized under new regulation

Extractives have the most exposure due to payment transparency regulation in the US, also being finalised by the EC. Telecoms, construction and banks, proposed though not included in EC regulation, remain exposed longer term. Closer regulatory scrutiny has not disappeared and we rate companies in these sectors, also analysing the key industry specific issues presented. Companies in Aerospace & Defence and Cap goods remain in the regulatory limelight.

"The corruption research from Kepler Cheuvreux's team builds extremely effectively on Transparency International's research methodologies and primary analysis to demonstrate the risks that investors face from corruption and how investments can be better protected by good corporate governance and putting in place adequate anti-corruption procedures." **Robert Barrington, Executive Director, Transparency International UK**

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A note on our approach to sources

We neither confirm nor deny allegations reported by the media in including them in this report. ESG analysis requires us to consider all stakeholders and media sources in order to assess potential reputation risk for investors. In this report we use a variety of journalistic sources, including local ones where we feel they reflect a relevant area of risk. Often allegations will surface long before evidence is objectively presented or any official announcements are made either by authorities or less so by companies themselves. However, they are of key interest to investors as newsflow, and critical within the context of the reputational risk we examine.

All sources mentioned as allegations are systematically referenced in the Notes at the end of this report in order to be traceable.

The Kepler Cheuvreux Corruption Exposure Index integrates factors, including public declaration of anti-corruption systems, geographic zones of activity and the news flow of corruption allegations which can increase a company's corruption exposure and therefore the potential materiality for investors in an increasingly tightened global regulatory environment. The index should under no circumstance be used to declare certain companies as engaging in corrupt practices and is not intended as such. We explicitly make no such claim of potential corrupt practices in relation to any company regardless of their position within the index.

Executive summary

Key risk factors analysed and scored

In this report, we score companies on their risk exposure to corruption using the key criteria of public disclosure of anti-corruption systems, geographical disclosure, jurisdictional exposure, past settlements and current allegations. Companies in key sectors receive a grade from A to F. The scoring system for public transparency is based on a methodology created by Transparency International which we would consider to be the benchmark in its area. We add certain criteria around the area of whistle-blowing which we maintain as playing a central role in protecting companies and therefore investors against corruption risks.

Extractives on front line

The oil & gas and mining sectors which have been exposed to corruption risks and a number of high-profile cases perform strongly in the area of public disclosure - we note however that geographical exposure to countries where there is a high risk of corruption remains the highest for this sector. We remind investors that even with strong disclosure of anti-corruption systems, current allegations still present critical risks for investors even though they sometimes date back a number of years. This is the case with Total SA, ENI, and Saipem S.p.A.

We focus on the extractives sector explicitly as payment transparency regulation has been enacted in the US and is currently being finalised in the EC for the sector. It will require country-by-country reporting of the major payment types to governments at a national and project level. Our view is that those companies with the highest quality anti-corruption systems will be best positioned for such legislation whose major ramifications will be in the area of uncovering illicit payments.

Forestry makes an appearance

Forestry has been included in EC legislation proposals and we identify it as a key sector. Its disclosure is poorer than its oil & gas and mining extractive peers and in the coming years we would expect logging activity to be the subject of greater focus.

Telco, construction and banks now on radar long term

We also present a broad overview of three other sectors which had been proposed for payments transparency: telco, construction and banks - these sectors have been dropped but in the long term are more likely to be included again within future legislation. Telecoms companies have had a number of allegations primarily related to the acquisition of licences in emerging markets. We reiterate concerns regarding the ongoing risks to investors where companies in this sector have not implemented adequate systems against corrupt payments.

Construction is a sector that performs poorly on disclosure but where allegations, though smaller in scale than extractives and telco, continue to have an impact on investors.

In a small sample of companies within the banking sector, we highlight that disclosure remains poorer as a whole and that risks around illicit payments feed into a number of major recent controversies that are affecting shareholder value.

Table 1: Kepler Cheuvreux Exposure Index

Company	Sector	Disclosure score grade based on TI methodology	Risk Exposure View (after adjustments) (100=max)
ZODIAC SA HOLDING	Aerospace & Defense	F	100
MAUREL ET PROM	Oil & Gas Producers	F	99
GLENCORE	Mining	F	96
EADS	Aerospace & Defense	C	88
RHEINMETALL AG	Aerospace & Defense	E	85
ENRC	Mining	C	84
ERAMET	Mining	E	84
LUNDIN PETROLEUM	Oil & Gas Producers	E	82
BOSKALIS	Construction	E	82
TECNICAS REUNIDAS	Oil Services	E	81
IMPREGILO	Construction	D	81
ENI	Oil & Gas Producers	B	80
NESTE OIL	Oil & Gas Producers	E	80
BOURBON	Oil Services	D	79
SAIPEM	Oil Services	B	78
DASSAULT AVIATION	Aerospace & Defense	E	78
TOTAL	Oil & Gas Producers	B	77
ALLIANCE OIL COMPANY	Oil & Gas Producers	D	76
MAYR-MELNHOF KARTON AG	Paper & Forestry	E	76
TOGNUM	Aerospace & Defense	D	74
VALLOUREC	Oil Services	D	73
ROLLS ROYCE	Aerospace & Defense	C	73
ASTALDI	Construction	C	72
OHL	Construction	C	72
KONE CORP	Capital Goods	E	72
SUBSEA 7	Oil Services	C	70
ANSALDO	Capital Goods	D	69
METSA BOARD	Paper & Forestry	D	67
PRYSMIAN	Capital Goods	D	67
ERICSSON	Telecoms	B	67
ALFA LAVAL	Capital Goods	D	67
ENCE	Paper & Forestry	F	66
FINMECCANICA S.P.A.	Aerospace & Defense	C	66
ALSTOM	Capital Goods	B	65
ESSAR ENERGY	Oil & Gas Producers	C	65
SAFRAN S.A.	Aerospace & Defense	D	64
ERG	Oil Services	E	63
SBM OFFSHORE	Oil Services	B	63
CGG	Oil Services	C	62
ABERTIS	Construction	D	60
TENARIS	Oil Services	C	59
GALP ENERGIA	Oil & Gas Producers	C	59
THYSSENKRUPP AG	Aerospace & Defense	C	58
PGS	Oil Services	B	58
TELENOR	Telecoms	C	58
BILLERUD	Paper & Forestry	D	58
MILLICOM	Telecoms	B	57
TELIASONERA	Telecoms	B	57
CAF	Construction	D	57
NEXANS	Capital Goods	D	57
TELEFONICA	Telecoms	C	56
REPSOL	Oil & Gas Producers	B	55
SARAS	Oil & Gas Producers	C	55
SAAB AB	Aerospace & Defense	C	55
LEGRAND	Capital Goods	C	54
BHP BILITON	Mining	A	53
FCC	Construction	C	53
TECHNIP	Oil Services	B	53
MTU AERO ENGINES GMBH	Aerospace & Defense	D	53
AREVA	Mining	C	52
XSTRATA	Mining	B	51
VOPAK	Oil Services	C	51
UPM KYMMENE	Paper & Forestry	C	51
TULLOW OIL	Oil & Gas Producers	A	50
TELEKOM AUSTRIA	Telecoms	B	50

Source: Kepler Cheuvreux

Table 2: Kepler Cheuvreux Exposure Index

Company	Sector	Disclosure score grade based on TI methodology	Risk Exposure View (after adjustments) (100=max)
BOLIDEN	Mining	C	50
BP	Oil & Gas Producers	A	49
SCHNEIDER	Capital Goods	C	49
AHLSTROM	Paper & Forestry	C	48
KONINKLIJKE PHILIPS	Capital Goods	B	47
ELECTRONICS N.V.			
NORSKE SKOG	Paper & Forestry	C	47
VINCI	Construction	C	47
SANDVIK	Capital Goods	B	45
BILFINGER	Construction	C	45
SACYR VALLEHERMOSO SA	Construction	C	45
SMURFIT	Paper & Forestry	C	45
SMITHS GROUP	Capital Goods	C	45
ANTOFOGASTA	Mining	C	45
ORKLA	Capital Goods	C	43
FRANCE TELECOM	Telecoms	B	43
ANGLO AMERICAN	Mining	A	42
BOUYGUES	Construction	C	42
FRAPORT	Construction	C	42
TELE2	Telecoms	C	42
ACS	Construction	C	42
TELECOM ITALIA	Telecoms	C	42
RD SHELL	Oil & Gas Producers	B	41
FERROVIAL	Construction	C	41
ATLAS COPCO	Capital Goods	B	40
SCA	Paper & Forestry	B	40
HOLMEN	Paper & Forestry	C	40
NORSK HYDRO	Mining	B	40
REXEL	Capital Goods	D	39
ALCATEL LUCENT	Capital Goods	B	39
STORA ENSO	Paper & Forestry	B	39
OMV	Oil & Gas Producers	C	37
DEUTSCHE TELEKOM	Telecoms	C	35
EIFFAGE	Construction	C	35
MAN SE	Capital Goods	B	35
HOCHTIEF	Construction	B	33
KPN	Telecoms	B	33
WEIR GRP	Capital Goods	B	33
ARCELOR	Mining	B	31
RIO TINTO	Mining	A	30
AMEC	Oil Services	B	30
BAE SYSTEMS	Aerospace & Defense	B	30
THALES S.A.	Aerospace & Defense	B	28
ASSA ABLOY	Capital Goods	B	27
VODAFONE	Telecoms	A	24
BG GROUP	Oil & Gas Producers	A	24
MEGGITT	Aerospace & Defense	B	24
SIEMENS	Capital Goods	A	23
STATOIL	Oil & Gas Producers	A	22
SKANSKA	Construction	B	22
ABB	Capital Goods	A	21
BALFOUR BEATTY	Construction	A	17

Source: Kepler Cheuvreux

The Kepler Cheuvreux Corruption Exposure Index integrates factors, including public declaration of anti-corruption systems, geographic zones of activity and the news flow of corruption allegations which can increase a company's corruption exposure and therefore the potential materiality for investors in an increasingly tightened global regulatory environment. The index should under no circumstance be used to declare certain companies as engaging in corrupt practices and is not intended as such. We explicitly make no such claim of potential corrupt practices in relation to any company regardless of their position within the index.

Putting a price on illicit payments

Never has the focus on business ethics and the underlying transparency of capital flows and payments been so intense. Although governments' motives can sometimes be mixed with regard to enforcement against companies for their part in illicit payments, there is now undeniable momentum in investigations and subsequent prosecutions, aided by the additional media scrutiny that these entail.

In our 2012 report *Bribery & corruption: the trillion-dollar phenomena*, we assessed the material risks to shareholders within current global regulatory and enforcement contexts and found that shareholders had been exposed to the legislative effects of anti-corruption drives both directly through penalties and indirectly through legal costs, strategic impacts and governance concerns. We went on to work on a report for investors in the aerospace & defence sector in January 2013 to give detailed views of a benchmark survey launched by the Transparency International defence sector team. We now continue our focus in this area to build a series of indices to assess and score disclosure on anti-corruption systems based on the methodology created by Transparency International. We believe it is the best of its kind in terms of measuring anti-corruption disclosure and can be very usefully applied to other sectors.

Our approach assumes intrinsically that disclosure is a good thing – we believe that the more companies are able to reassure investors publicly that they understand the risks they face in the areas of business ethics and are protect themselves against them, the better positioned they will be for the real challenges in these areas that increased regulation and global enforcement pose in the long term.

We note a variety of improvements in legislative power in recent years – most notably the UK Bribery Act which some see as theoretically providing the world's strongest legal powers against bribery. However, the US continues to be the world's most aggressive prosecutor of corporate bribery cases and European companies continue to be in the crosshairs, with eight of the ten largest corruption penalties still assumed by European companies (and only one in the US). However, some high-profile activity has also occurred in Italy with the arrest of Finmeccanica's CEO and the investigation into ENI's CEO in relation to bribery allegations. The CEO of Total SA has also been answering questions related to the UN oil for food scandal in a Paris court over bribery allegations in January this year.

The number of legal frameworks and tools used to fight secrecy, the bedrock of corrupt payment flows, also continues to expand. One such example is in the area of country-by-country and project payment reporting, which has long been considered essential in the fight against corrupt payments by NGOs. With the passing of Dodd Frank Article 1504 in August 2012 in the US, and the EC currently proposing similar legislation, there is now clear momentum for a swathe of innovative legislation to tackle the incidence of corruption that the private sector is exposed to in its interaction with governments.

This report is part of an ongoing series on business ethics

Our ratings can be used for both sustainability models...

...and engagement

Transparency diminishes the secrecy on which corruption depends...

...and informs investors more precisely of risks presented

The first and most material impact of illicit payments is through bribery, and increased regulatory action resulting increasingly in reputational and financial impacts, both direct and indirect, on companies. This area is central to our study, as we believe companies with the strongest anti-corruption culture, policies and follow up will have least to fear from the increased regulatory and enforcement push globally.

An overview of penalties: US enforcement

Corporate business ethics penalties have shown an increase in the last five years in relation to a number of factors and violations. We note three major trends (see tables below):

- **Enforcement on corporate crime has massively increased in recent years. 2012, in particular, was a record year for criminal penalties against corporates, with six of the largest-ever fines imposed for a variety of allegations from environmental offences, through marketing malpractice, to anti-trust issues.**
- **Corruption in particular shows a much higher (indeed disproportionately so) tendency for non-US firms to be targeted. Eight of the top ten corruption penalties were meted out to European entities and only one to a US domestic concern.**
- **In the banking sector, US legal action for banks violating sanctions and money laundering regulation also sees seven European financial institutions in the largest penalties list.**

2012 a record year for criminal corporate penalties...

...and investors suffered

Table 3: Six of the largest ever corporate penalties came in 2012

Company	Sector	Country	Criminal penalty	Total penalty	Year	Offense
			USD	USD		
BP	Oil & Gas	UK	1,256 bn	4,5bn +	2012	Environmental
Pfizer	Pharma	US	1,2bn	2,3 bn	2012	Mis-Marketing
GlaxoSmithKline	Pharma	UK	956m	3bn	2012	Mis-Marketing
Eli Lilly	Pharma	US	515m	1,415bn	2009	Mis-Marketing
AU Optronics	Cap Goods	Taiwan	500m	500m	2012	Antitrust
Abbott Laboratories	MedTech	US	500m	1,6bn	2012	Mis-Marketing
Hoffman-La Roche	Pharma	Canada	500m	500m	1999	Antitrust
Yazaki	Cap Goods	Japan	470m	470m	2012	Antitrust
Siemens	Cap Goods	Germany	450m	2bn	2009	Corruption
Halliburton/KBR	Engineering	US	402m	579m	2008	Corruption

Source: Kepler Cheuvreux

Six of the top 10 criminal penalties administered in 2012

Table 4: The largest anti-corruption prosecutions to date under the FCPA

Company	Country	Sector	Year	FCPA settlements
				USD m
Siemens	Germany	Capital Goods	2008	800
KBR / Halliburton	US	Oil & Gas/ Engineering	2009	579
BAE Systems	UK	Defence	2010	400
Total SA	France	Oil & Gas	2013	398
Snamprogetti Netherlands B.V.	Netherlands/	Oil & Gas/ Engineering	2010	365
/ ENI S.p.A	Italy			
Technip SA	France	Oil & Gas	2010	338
JGC	Japan	Engineering	2011	219
Daimler AG	Germany	Auto	2010	185
Alcatel-Lucent	France	Telco	2010	137
Magyar Telecom/ Deutsche Telekom	Hungary/ Germany	Telco	2011	95

European companies in bold

Source: DoJ, SEC

Eight of the top 10 US corruption penalties were meted out to European companies...

Table 5: Sanction violations: majority of penalties administered to European entities

Bank	Country of domicile	Date	Main sanctioned countries	Total penalty USD m
HSBC	UK	N/A	Iran, North Korea, Burma, Sudan, Libya	1.9bn+
ING	Netherlands	June 2012	Cuba, Iran, Burma	619
Credit Suisse	Switzerland	December 2009	Iran	536
ABN Amro	Netherlands	October 2010	Iran, Libya, Sudan, Cuba	500
Lloyds	UK	January 2009	Syria, Iran, Libya	350
Standard Chartered	UK	August 2012	Iran, Sudan, Libya, Burma, Cuba	700m+
Barclays	UK	August 2010	Cuba, Sudan	298
Australia and New Zealand Bank Group	Australia/ New Zealand	August 2009		5.75
JP Morgan	US	August 2011	Cuba, Iran, Sudan	88.3

Source: Newswires, Kepler Cheuvreux

... and only one US institution makes it into penalties against banks for sanctions violations

Mapping corruption: our scores

Central to this report is the scoring of companies based on their public information on anti-corruption systems. Here's why we think disclosure is essential:

- Investors gain clear signals regarding risks to shareholder value from the disclosures given.
- The company itself directly indicates its awareness of the level of risks it could be exposed to.
- Stakeholders such as potential suppliers, agents and employees receive further clarity on the extent of procedures to limit corrupt payments. We believe that in some cases the strongest such policies and implementation can dissuade partners from offering corrupt payments and therefore potentially reduce investor risk.
- In legal terms, there is a clear argument that investors benefit from corporates who are given more lenient penalties as a result of effective anti-corruption systems which are taken into consideration as part of the litigation process. The UK Bribery Act specifically allows for corporates to use the defense of "adequate procedures" if they can prove they had commensurate systems in place to prevent bribery. US and other regulators will also generally take such systems into account in deciding whether to impose or reduce penalties. In some circumstances, a company could be able to avoid prosecution if it is able to prove best practice. Investors can be reassured as to the potential positioning of the company with quality disclosure. Such best practice systems, publically declared, are more likely to prevent the charge of "systematic bribery" which has led to the largest damages and penalties and shareholder losses, as in the case of Siemens.

Disclosure can be evidence of sound risk management...

... dissuasive device against potential wrong doing...

...as well as grounds to show that legal challenges could be handled optimally

Scoring methodology

We take a detailed look at the disclosure of the following;

1. **Disclosure of anti-corruption systems** - scored from A to F based on the system outlined below. This is above all in our view, *a forward-looking indicator*, as legacy allegations can take a number of years to materialise.
2. **Geographical exposure**
These are based primarily on reported revenues as per annual reports. Assets and production data are also taken into account where pertinent – primarily for the extractives sectors. As the exact exposure by country is rarely available, we take bands, as below, based on disclosure and supplement with information provided by our analysts where available. We further name countries where there is exposure based on reporting from press releases of new contract/ project announcements and interim financial statements.

We reiterate that country-by-country reporting is therefore intrinsic in allowing investors to fully assess corruption risk.

Disclosure: a forward-looking indicator

Without country-by-country reporting, corruption risks are far harder to evaluate with accuracy

Table 6: Geographical exposure scoring methodology

Revenue estimates from higher-risk countries %	Points (1-6)
0 %	1
1-9 %	2
10-19 %	3
20-34 %	4
35-49 %	5
50+ %	6

Source: Kepler Cheuvreux

Lastly, for extractives, a US listing in our view also explicitly increases the risk with Dodd Frank 1504 payment reporting and therefore any company exposed to this regulation receives a minimum geographic exposure score of “4”.

The basis of the “materiality” score therefore takes into account presence in risky emerging countries, as these increase bribery exposure. We would consider the countries below the Top 40 (below Poland in rank) within the Transparency International CPI Index to have an increasingly high risk as we go down the list (see *Appendix*). The number of countries we are defining as “risky” is larger than many norms, as we believe it is not the pure CPI score that determines corruption risk for a corporate, but also the overall profile of cases investigated from activity originating from that country. This will in some part be related to Foreign Direct Investment (FDI), as the volume of trade from capital inflows combined with the perceived corruption risk allows for a more specific view of the business risks.

We include Poland as the starting point in the riskier country list, as while it would not necessarily be identified as a high-risk country by many measures, we note an increase in the number of high-profile investigations and penalties against foreign companies in that country. These include Philips, IBM, Eli Lilly, and Johnson & Johnson in the last two years.

3. **Risk exposure view** - scored from A to F to give an indication of the overall corruption risk management the company shows in terms of its disclosure of anti-corruption systems in light of the challenges of its geographical diversity. This is adjusted to give an overall view of how the company manages its risk. *Where significant allegations show that there is ongoing risk for investors from legacy cases, this will pull down the score even if disclosure scores well.*

Allegations can have a big impact on shareholder value – we take that into account

Table 7: Allegations lead to adjustments

Allegations	Score	Adjustment
CEO & Board level impact/ SEC investigation	D	-20%
Official regulator actions incl. probes/ raids and / or multiple credible allegations	C	-10%
Credible press / NGO allegation	B	-5%
No meaningful allegations found/ settlement reached with no recurrent allegations	A	0 (No adjustment)

Source: Kepler Cheuvreux

This adjustment for allegations includes probes and settlements declared as currently under negotiation – the original alleged activity may often have occurred before anti-corruption systems were implemented and disclosed.

The highest scores in the table are from companies such as Statoil and Balfour Beatty which do have significant past settlements; however, a lack of repeat allegations indicates in our view that with strong policies the potential for substantial future impacts for shareholders has been reduced and is being managed via the anti-corruption systems disclosed.

The very best scoring companies often had prior settlements and have been forced to reform

Table 8: Assessing disclosure based on transparency international methodology

Anti-corruption systems	Desk-based research of 29 questions based on CEO & Board Involvement, Risk Assessment, Policies & Codes, Training and Whistle Blowing Systems
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Source: Kepler Cheuvreux, Transparency International

This approach originates in the methodologies created by NGO Transparency International - for anti-corruption systems, we take questions used in the Defense Anti-Corruption Index, which we believe to be the most pertinent and exhaustive questionnaire on corporate anti-corruption systems disclosure to date. We have extracted the majority of questions which we hold to be relevant for the sectors we analyse and have added a number of areas related specifically to whistle blowing.

Below are the questions used to assess anti-corruption systems disclosure:

The questions originate from global benchmark 2012 TI Defense Companies Anti-Corruption Index

Table 9: Anti-corruption disclosure questionnaire based on Transparency International survey

Leadership and commitment	
1	Does the company publish a statement from the Chief Executive Officer or the Chair of the Board supporting the anti-corruption principles of the company?
2	Has the company appointed a board committee or individual board member with overall corporate responsibility for its Integrity Building and Anti-Corruption (IBAC) policy and programme?
3	Is there regular senior management monitoring and review of the performance of the company's Integrity Building and Anti-Corruption (IBAC) programme?
4	Does the company review and where appropriate update its policies and practices in response to actual or alleged instances of corruption?
Risk assessment	
5	Does the company have a formal anti-corruption risk assessment procedure for assessing business decisions, with clear requirements on the circumstances under which such a procedure should be applied?
	<i>Partners and agents :</i>
6	Does the company conduct due diligence that guards against corruption risk when selecting its agents?
7	Does the company have contractual arrangements and processes for the monitoring, control and audit of agents with respect to corruption?
8	Does the company make clear to contractors, sub-contractors and suppliers, through policy and contractual terms, its stance on bribery and corruption and the consequences of breaches to this stance?
Company policies and codes	
9	Does the company publish a policy making clear its commitment to anti-corruption?
10	Is the anti-corruption policy explicitly one of zero tolerance?
11	Does the anti-corruption policy explicitly apply to all employees?
12	Does the company have a policy on potential conflicts of interest, and does it apply to both employees and board members?
13	Does the company's anti-corruption policy include a statement on the giving and receipt of gifts that ensures that such transactions are not corrupt?
14	Does the company have a clear policy prohibiting facilitation payments?
15	Is the company explicit in its commitment to apply disciplinary procedures to employees found to have engaged in corrupt activities?
	<i>Political and charitable involvement :</i>
16	Does the company prohibit political or charitable contributions, or regulate such contributions in order to prevent undue influence or other corrupt intent?
17	Does the company have a clear policy on engagement in lobbying activities, in order to prevent undue influence or other corrupt intent?
Training	
18	Does the company provide written guidance to help employees understand and implement the Integrity Building and Anti-Corruption (IBAC) Policy?
	<i>General Training</i>
19	Does the company have a training programme that explicitly covers anti-corruption?
20	Is anti-corruption training provided in all countries where the company operates or has company sites?
	<i>Specialist training</i>
21	Does the company provide targeted anti-corruption training to senior managers and members of the Board?
22	Does the company provide different levels of anti-corruption training for employees in sensitive positions?
Whistle blowing (* = additions from Kepler Cheuvreux)	
23	Does the company have well-publicised communication channels through which any employee can report suspected instances of corrupt activities?
24	Does the company have well-publicised resources available to all employees where help and advice can be sought on corruption-related issues?
25	Is there a commitment to no retaliation for bona fide reporting of corruption?
26	Does the whistle-blowing system allow for anonymity? *
27	Is the whistle-blowing channel located externally? *
28	Does the company disclose the number of disciplinary measures as a result of follow up from reports passing through the whistle blowing system? *
29	Does the company disclose the number of reports passing through the whistle-blowing system? *

Source: Transparency International , Kepler Cheuvreux

Best and worst practices: What really differentiates companies?

Below are the questions which correlate to the best and worst scores –worst practice is more self-evident: if a company does not disclose even any theoretical anti-corruption commitment, it is unlikely to be able to implement the accompanying systems to ensure the reduction of corruption risks. We would say that failure to answer positively and clearly on these base questions represents a clear risk to shareholder value for any company with a global presence and in the riskier sectors.

By contrast, those best practice questions to the left of the table require a level of awareness on the company's part of its own risks and also a level of implementation which can be considered advanced in order to disclose publicly that it conducts anti-corruption due diligence systematically in M&A activity. We look at specific disclosures later in the report to highlight best practice.

Table 10: What differentiates the best & worse companies

	Best practices	Average score for companies with positive response	Worst practices	Average score for companies with negative response
1	Due diligence for M&A	High B	Clear anti-corruption commitment	F
2	External whistle blowing system	B	Applies to All employees	F
3	Training for senior managers/ Board	B	Employee written guidance	F
4	Risk assessments for business decisions	B	Conflict of interest policy	F
5	Training in all countries	B	Policy on gifts & hospitality	F

Source: Kepler Cheuvreux

Disclosure scoring bands (A-F):

We follow the scoring bands used in the TI Defense Group Survey which range from “A” (best) to “F” (worst). An aggregate score of 83% or above must be achieved for an “A” grade. “A” and “B” would be considered that good evidence exists of sound policies against corruption. “C” and “D” scores are “intermediate” with “E” and “F” scores meaning that disclosure is either poor or almost non existent.

Expanding the Transparency International methodology

Additional whistle-blowing questions

We base our questions largely on those used in the survey, but we add a number of questions in the area of whistle-blowing.

Table 11: Additional questions on whistle-blowing systems

1	Does the whistle-blowing system allow for anonymity?
2	Is the whistle-blowing channel located externally?
3	Does the company disclose the number of reports passing through the whistle-blowing system?
4	Does the company disclose the number of disciplinary measures as a result of follow up from reports passing through the whistle-blowing system?

Source: Kepler Cheuvreux

There are some critical reasons why whistle-blowing criteria are central:

- Whistle blowing is the **primary source of information** for authorities who will likely instigate probes on the basis of third-party evidence provided to them directly. During recent anti-trust proceedings against Microsoft, for example, it was revealed that competitor Google had tipped off the EC with details of settlement violations regarding the lack of choice in using the default Explorer browser in Windows operating systems. Corruption allegation anecdotal evidence suggests that agents and competitors present reports confidentially to authorities.

What do the disclosure scores indicate?

Investors should understand that whistle blowing is the primary source of corruption allegations

- **Rewards** for the practice have become exceptionally large in the US. For the recent case against GSK in the US where settlements exceeded USD3bn, it is estimated that the primary whistle blowers in the case may share in the region of USD100m-150m. Whistle blowers who claimed that the companies rebutted them internally have also been very publicly behind recent bribery allegations against EADS and Rolls-Royce.
- **Several companies now under investigation and in the public eye regarding allegations (whether they turn out to be true or not) have been accused** of having insufficient whistle-blowing systems and protection to follow up on reports internally by their own employees. **We believe it is critical for companies to reinforce their internal whistle-blowing systems to the maximum to prevent the penalties and reputational fallout.**
- **Protection** for those reporting allegations is increasing at a national regulatory level and is already very strong in several territories in developed markets – most obviously the US, as a result of Sarbanes Oxley and Dodd Frank regulation.
- Should a company be able to capture an allegation internally before an informant contacts external government authorities, it is in a much better position to resolve and/or minimise subsequent penalties. There is evidence that companies that "self-report" allegations, which they capture and investigate through their own systems are treated more leniently by the authorities.

Certain territories may show less cultural acceptance of whistle blowing, notably Continental Europe and France. Indeed, due to personal data protection legislation, French "CNIL" laws restrict some uses for which whistle-blowing channels may legally be used; however generally there is no legal reason why a company should not be able to implement an anonymous channel that covers corruption reports. We add that companies that strive to be perceived as global, and derive most of their revenue and operational activity abroad, should think twice about such arguments regarding culture in the domestic country when confronted with the **global risks** usually faced.

In our view, whistle-blowing systems are particularly important not just in the area of corruption, but also to allow stakeholders to report a variety of potential issues that can strengthen a company's culture and response to material problems across its operations and locations. Critically this will include potential health & safety violations being reported and potentially acted upon before significant investor risk has accrued.

Best practices: examples

Facilitation payments

This is an area where a number of companies have improved policies and disclosure, and we note in particular the UK Bribery Act in 2011 which outlaws facilitation payments. It is therefore particularly important for companies with any kind of links to the UK, whether through operations, supply chain, logistics, procurement, agents, financial services or clients, to ensure that such a policy prohibiting the payments is explicit open, know and enforced.

However, until now we have not seen any explicit prosecutions against companies for using such payments and, indeed, other countries within Europe including France and Germany,

Whistle-blowing pays...

...but retaliation costs

Many developed countries have whistle-blower protection regulation

Internal investigations have better outcomes than external ones

Anonymity? True, some countries would use this less...

...but global companies aren't exclusively based in those countries

What about small routine payments to government employees for services or products already due?

with similar prohibitions against such payments, have not at the time of writing used the legislation in place to any major degree.

Rio Tinto, with a primary listing and major management office in London would certainly be exposed to the UK Bribery Act. Its approach to facilitation payments states clearly "The only way to guarantee compliance with UK laws on bribery is to avoid making facilitation payments anywhere in the world". It goes on to recommend that operations set out a long-term strategy to reducing exposure to these payments and receipt or written confirmation of its legality, inform senior officials of relevant government agencies about any unofficial requests for cash, and seek to build alliances with other firms facing similar problems."

Lobbying

We found this area to be one of the most difficult in which to find good practice. Best practice is perhaps still some way off.

Disclosure of lobbying subject areas and geographical zones, full time equivalent lobbying employees, industry body representation, independent lobbying firms used, think tank and focus group funding and budgets (direct & indirect) are scant among many of the best overall scoring companies. The SEC has considered tightening disclosure requirements for both political spending and lobbying, but no final rules have been proposed. The risk is not just reputational and regulatory but of course intrinsically political – any change in position of the individual and/or the political party connected to the lobbying can of course jeopardise any agreement or regulatory favour achieved. Some aggressive lobbying activity is clearly risky as it comes much closer to the line between legal and prohibited activity, and even more so as even neighbouring countries can have widely different accepted standards of probity in relation to political and lobbying actions.

However, Norsk Hydro is starting to achieve some areas of declaration which we believe are warranted in terms of investor interests.

The company details areas in which it is active and in a dedicated *Public affairs and lobbying* section of the sustainability report, it highlights membership of industry associations and key countries in which it is active, declares its subscription to the Code of Conduct for Lobbying in the European Parliament, and public reporting in the EU via the EU Transparency Register. It also details employment: "*In Norway and Brazil about one full-time equivalent is dedicated to lobbying activities in each country.*"

Another example of a lobbying policy with specific risk mitigation items include that introduced publicly last year by **Telekom Austria** – which has had to deal explicitly with controversies in this area. It highlights approval requirements that include vendor integrity checks for lobbyists and the forbidding of success fees, with strict additional multiple sign-off requirements from the local management board, and the extended management board when lobby budgets exceed EUR100,000.ⁱ

There are several examples cited at the end of this report (one example is with Spanish construction company allegations) related to potential corruption as a result of political lobbying.

Risk assessment for business decisions

Statoil, the best performer all round for anti-corruption systems disclosure, notes a variety of processes integrated into its operational and business models that are related to the following risk areas:

- Country risks (as evidenced by perceived high levels of corruption and an absence of effectively-implemented anti-corruption legislation, among other factors).
- Transaction risks (such as those associated with social investments, interactions with public officials or transactions relating to public procurement).
- Business opportunity risks (such as those associated with projects involving intermediaries acting on Statoil's behalf).
- Business partnership risks (such as those associated with joint ventures and the use of intermediaries or others acting on Statoil's behalf in transactions with public officials).

Due diligence for M&A

Arcelor Mittal shows best practice in disclosure regarding M&A risk, which as a globally diversified entity with a history of acquisitive activity is clearly material to it. In a dedicated section on M&A corruption risk, the company explains the concept of "successor liability" where the company takes on legacy responsibility for the company it acquires if corrupt activities have taken place. It goes on to explain the technical detail of asset acquisition and how such activity should also receive due diligence even if legally there is less risk for the company.

Third-party contractual obligations

Here **Arcelor Mittal** also publicly discloses a model clause for contracts showing clearly a legal obligation for those hired by the firm to abide by specific responsibilities in the area.

[CONTRACTOR] agrees to comply fully with all applicable anti-corruption laws, including those in the jurisdiction where they are registered and the jurisdiction where the relevant contract will be performed (if different), and to comply with ArcelorMittal's Anti-Corruption procedure.

Training of Higher Risk Personnel

Vodafone has a clearly set out policy in this area with online training available to all employees, with further face to face training for higher risk personnel.

"Communication and training: Our anti-bribery policy is included in our Code of Conduct, promoted on a dedicated intranet page with supporting guidance, and supported by a global training and communication programme that includes an anti-bribery eLearning tool available to all employees. Face-to-face workshops in all our markets help ensure employees working in high-risk areas (such as procurement, enterprise and government relations) have a practical understanding of the key issues"

Whistle blowing: transparency of usage

BG Group demonstrates to stakeholders that its communication channel for reporting and grievances has made some progress by stating exact numbers of reports passing through the system. This is still all too rare and we believe it is one of the key differentiating factors of the best whistle-blowing systems. Like the best codes and policies, the fact that they exist does not equate to them being used. As stated, whistle-blowing is the key device

through which complaints come to court – should a company have a chance to treat allegations before the press or prosecutors begin their work, they are much better positioned to limit damage and propose solid internal reform, and retain the goodwill of the staff concerned.

We remain cautious on companies with large global supply chains that declare (sometimes with significant pride) that they have had no whistle-blowing cases from their internal systems for a number of years.

However, this can be an indicator that the system is not well embedded into the company culture and serves more as window-dressing than being at the forefront of the risk management system.

“Nothing to declare?”

Table 12: BG Group: whistle blowing system usage statistics

Usage %	Category
	During 2011, 134 cases were reported under the Speak Up facility (2010: 151 cases). Each reported case is investigated or overseen by the ECCU.
38%	Reported malpractice (including allegations of breaches of the group's ethical conduct policy and Standards, breaches of the group's ethical conduct policy and standards , including corruption);
33%	General workplace concerns (including allegations of harassment, discrimination, unfair hiring practices and unfair treatment) harassment, discrimination, unfair hiring practices and unfair treatment);
19%	Fraud (including allegations of theft or misuse of funds);
10%	Health, safety , security and the environment.
Disciplinary measures :	28 Investigations resulted in disciplinary measures (21% based on total cases reported)
	37 Cases resulted in changes to procedures

Source: BG Group Sustainability Report 2011

What makes disclosure more material?

We believe that companies with exposure to the following will have the most material corruption risks:

1. Geography:

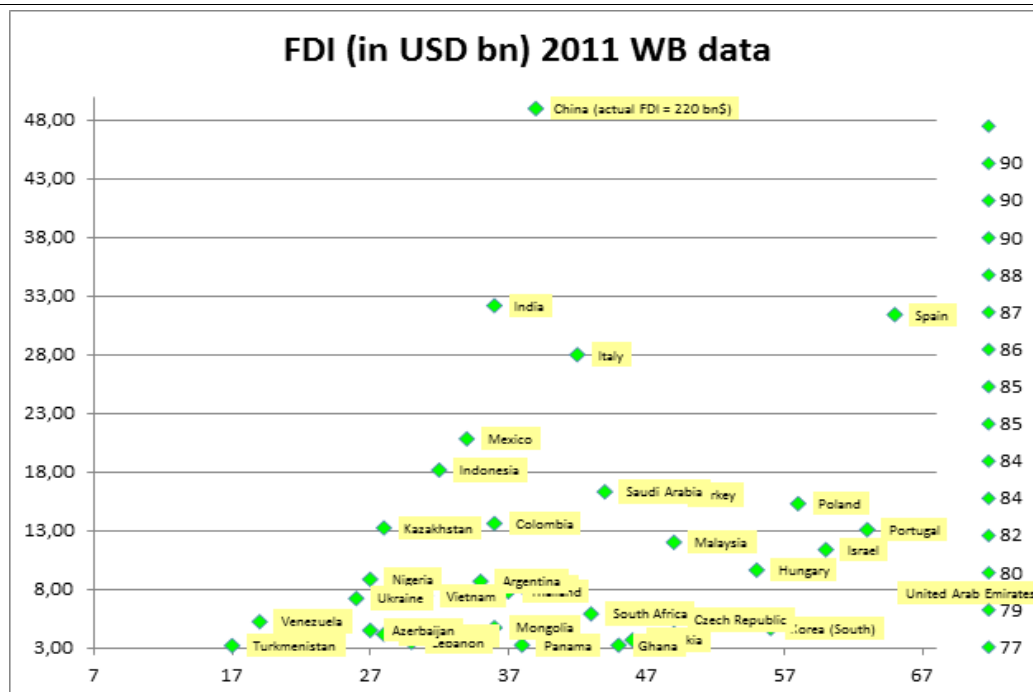
Emerging-market revenues and geographical diversity: While the overall number of countries of operation will increase the complexity and expense of managing anti-corruption systems, it is operations in high-risk emerging market countries that will carry the most risk. Almost all countries below the top 40 in the Corruption Perceptions Index list are in emerging markets. While bribery does not exclusively occur in emerging markets, it is a lot more common in those territories. The more geographically diversified the company is, the more investment will be needed to coordinate and implement anti-corruption systems in all territories.

Table 13: Top 15 countries for corruption by cap inflows (FDI)

Country / Territory	CPI 2012 Score	FDI (in USDbn) 2011 data
China	39	220,14
Brazil	43	71,54
Russia	28	52,88
India	36	32,19
Italy	42	28,00
Mexico	34	20,82
Indonesia	32	18,16
Saudi Arabia	44	16,31
Turkey	49	16,05
Poland	58	15,30
Colombia	36	13,60
Kazakhstan	28	13,23
Malaysia	49	12,00
Hungary	55	9,63
Nigeria	27	8,84

Source: World Bank, Transparency International

Where's the risk really?

Chart 1: Largest corruption risk on left hand side versus largest capital inflows (from top)

Source: World Bank Data, Transparency International CPI 2012, Kepler Cheuvreux

The US connection: It is important to note any links, even weak ones, with the US as it has claimed a number of non-domestic scalps in its history of aggressive corporate prosecutions. Predominantly local and developed market scandals, such as EADS in Austria with Eurofighter, and NewsCorp in the UK (phone hacking, where bribery of the UK police was an element) is the exception rather than the rule. However, even here the risk of contagion and falling under the US regulatory orbit remains material.ⁱⁱ

Extractives with SEC Listing: Oil & gas and mining companies with an ADR Level II or III listing on US exchanges will be under the scope of Dodd Frank 1504 payment reporting as of 2014. Those companies subject to the reporting are in our view more likely to undergo scrutiny regarding their performance on anti-corruption. Furthermore financial journalists and NGOs will certainly use the data to the full extent possible to uncover anomalies, outliers creating further reputation risk for such companies.

2. Sector of operation:

While no sector is immune from corruption, there are certain sectors that are consistently more exposed to illicit payments and therefore prosecutions. However, all sectors have some level of risk, and two of the major allegations to emerge in the last year have been in sectors not typically high risk: retail (WalMart) and media (NewsCorp) – we do not therefore give scores a sector weighting.

Table 14: Sector risks: bribe payers index (low score = more corruption)

Rank	Sector	Sector Score
1	Agriculture	7.1
1	Light manufacturing	7.1
3	Civilian aerospace	7.0
3	Information technology	7.0
5	Banking and finance	6.9
5	Forestry	6.9
7	Consumer services	6.8
8	Telecommunications	6.7
8	Transportation and storage	6.7
10	Arms, defence and military	6.6
10	Fisheries	6.6
12	Heavy manufacturing	6.5
13	Pharmaceutical and healthcare	6.4
13	Power generation and transmission	6.4
15	Mining	6.3
16	Oil and gas	6.2
17	Real estate, property, legal and business services	6.1
17	Utilities	6.1
19	Public works contracts and construction	5.3
	Average	6.6

Source: Transparency International Bribe Payers Index

3. Current allegations:

Allegations, even when unfounded, cause damage with regard to the share price, reputation, contracts in negotiation, investigation & legal costs, and operational disruption from senior resignations. We believe they form an integral part of the risk assessment for investors and the allegations are taken into account in the Final Risk Score.

A cautionary tale for small and mid caps: no exemptions

Investigations for smaller companies are rarer than large caps and penalties will tend to be proportionately smaller. The UK Bribery Act explicitly looks at *proportionate* procedures for the size of the firm as criteria in taking into account corporate liability. But we take the view that small and mid-caps should not feel exempt from anti-bribery laws. We take the example in the US of Team Inc, in the engineering services sector. At the time of writing, its market cap was around USD767m, with revenues under “Other foreign countries” accounting for only 4.33% of total revenues. An 8-K SEC filingⁱⁱⁱ indicated legal costs of USD3m for a bribe reportedly at the value of USD50, 000 in Trinidad - for a market

Its not just a risk for large caps...

... smaller companies can be disproportionatley affected

representing less than one half per cent of revenues. A further figure of USD3.2m was given for professional costs for the FCPA investigation were in Q4 2010 results. At the time of writing, while no penalty has been enforced on the company, legal costs were clearly encountered. For those smaller companies, any such legal costs can come to represent a more potentially disruptive chunk of free cash flow than for many of the large cap companies under investigation.

Scoring corruption risk exposure: a three-step process

Table 15: Scoring corruption risk exposure

1. Disclosure of anti corruption systems

(% → Grades: A-F)

Area	Description
Leadership & Commitment	« Tone from the top », without this the policy has no teeth
Risk Assessment	Complex global operations need to know when, how and where to apply resources
Codes & Policies	The first step, but without implementation through the other areas is not worth much
Training	Employees need to know the specifics and how they will be held accountable
Whistle Blowing	Without sound reporting channels people don't have confidence to air issues



2. Geographical exposure

(% → Scores 1-6)

Geographical exposure	Score	Multiplier
0 %	1	X 1,6 (Minimum score =C)
1-9 %	2	X 1,3 (Minimum score =D)
10-19 %	3	X 1
20-34 %	4	X 0.9
34-49 %	5	X 0.8
>50 %	6	X 0.6



3. Allegations

(A= 0, B=-5, C=-10 or D=-20)

Allegations	Adjustment
CEO & board level impact / SEC investigation	-20 % (D)
Multiple allegations	-10 % (C)
Press or NGO allegation	-5 % (B)
No allegations found	0 % (A)

Source: Kepler Cheuvreux

Regulatory prospects

New regulations in the area of payment transparency are intrinsic to uncovering corporate involvement in corruption. Although the UK Bribery Act has received much press exposure, we would argue that in the long term Dodd Frank 1504 and the EC Accounting Directive payment transparency regulations also have the potential to be used as one of the most significant regulatory tools in the fight against global corruption. Both the EC and US authorities build on the work of the EITI - but noteworthy is that though the US regulation included oil & gas and mining companies the EC alone is currently proposing to include Forestry. Beyond this, the telco, construction and banking sectors were also proposed for country-by-country reporting in the EC, but the idea was dropped. We thus expect a continued push for an extension of regulations to such sectors in the longer term.

In our view, increased transparency via country and project-level payments allows investors to have additional visibility on a number of areas of risk exposure not limited to corruption, but also geopolitical and localised issues and reputational.

Both the US and EU have taken legislative steps to mandate payment transparency. The fundamental principle of the legislation is that visibility over payments – which are sometimes contractual requirements for companies – will reduce corruption by making the financial flows much clearer. Where bribery, embezzlement, aggressive tax avoidance, fraud and mismanagement has occurred, it is more likely to be uncovered.

The risks

The US has been the most aggressive extra territorial regulator in terms of enforcing a variety of regulation with social and foreign policy implications such as the anti-bribery FCPA legislation and sanctions violation laws. In both cases, as the tables on page 8 show it is certainly European companies that have borne the lion's share of large penalties. Politics (with a subtext of protectionism) can undoubtedly play a part in the enforcement but the conclusion is clear – globally-operating European companies are very much at a level of elevated prosecution risk. Given the uneven history of larger penalties towards European companies, increased political will to tackle budgetary constraints and the continuing relevance of US markets to global corporates, *we believe the strongest risk comes from the US rather than the EU in the short to medium term.*

Who pays, the shareholder or management?

Shareholders bear the brunt of the prosecutions. There have been signals from regulators that individuals will be held to account, but cases are still rare. A number of regulators have stated this unequivocally, and, most recently, the Chief Executive of the UK FSA said that "unless individuals are held to account" raising penalty levels would not change corporate behaviour. The former US Senator Arlen Specter stated "*Criminal fines are added to the costs of doing business...going to jail is what works to deter crime*". However, the only major case in which a former CEO has gone to jail for bribery is that of KBR in the Nigeria Delta Bonny Island Scheme. Recently, by contrast, the US was unable to pursue its case against former Siemens executives for their alleged part in South American payments.

We chose sectors based on initial EC proposals for payment disclosure as indication of long term regulatory focus on corruption

The US regulatory and enforcement regime still poses biggest risk

Italy saw some pre-election enforcement with the arrest of Finmeccanica's CEO Giuseppe Orsi in March 2013 and the investigation of ENI SpA's CEO Scarone. We await to see if major precedents will be set in terms of personal penalties.

Table 16: Former CEOs impacted by bribery allegations

Company	Year	Country	Impact
Statoil	2003	Norway	Resignation
BAE	2008	UK	Questioned at US airport
Innospec	2010	US	Extradited on bribery charges, fined USD 229000 for FCPA violations
Finmeccanica	2011	Italy	Resignation
LatiNode	2011	US	Sentenced to 46 months
Avon	2011	US	Resignation
MAN Diesel & Turbo	2011	Germany	Resignation
Noble Drilling	2011	US	Charged with FCPA violation
KBR	2012	US	30 Month jail term
Saipem	2012	Italy	Resignation
MAN SE	2012	Germany	Probed
Finmeccanica	2013	Italy	House Arrest
TeliaSonera	2013	Sweden	Resignation
SNC Lavalin	2013	Canada	Arrest

Source: Kepler Cheuvreux, Newswires

Dodd Frank 1504

The US Act was implemented on 22 August 2012 for US listed companies required to file an annual report with the SEC.

We will examine the proposed EC legislation in the next section which builds directly on and undoubtedly gained political traction from Dodd Frank 1504.

Companies exposed

Any extractives company with a US listing that needs to file an annual report is covered by Dodd Frank 1504. The definition includes commercial development, processing and export activities. For the vast majority of European companies this means an ADR Level II or III listing.

An argument used by certain companies is that regulatory changes in the US and Europe leave a group of developed markets companies disadvantaged as their competitors outside these markets are not obliged to report. As the table below shows, a number of the world's largest extractives companies are already listed in US markets.

More evidence the US is both willing and able to legislate business ethics

A chunk of non European Extractives ADRs are listed in the US

Table 17: Not just US & EU Companies covered by Dodd Frank 1504

Company	Country	ICB Sector Name
Petrochina -ADR	China	Oil & gas producers
BHP Billiton-ADR	Australia	Mining
Petrobras-SP ADR	Brazil	Oil & gas producers
China Petro-ADR	China	Oil & gas producers
Ecopetrol-SP ADR	Colombia	Oil & gas producers
Vale SA-SP ADR	Brazil	Mining
CNOOC LTD-ADR	China	Oil & gas producers
SASOL LTD-SP ADR	South Africa	Oil & gas producers
Yanzhou Coal-ADR	China	Mining
Anglogold AS-ADR	South Africa	Mining
Aluminum Cor-ADR	China	Industrial metals & mining
Randgold Res-ADR	Jersey	Mining
Buenaventura-ADR	Peru	Mining
Sid Nacional-ADR	Brazil	Industrial metals & mining
Sterlite Ind-ADR	India	Industrial metals & mining
YPF SA-ADR	Argentina	Oil & gas producers
Gold Fields-ADR	South Africa	Mining
Alumina LTD-ADR	Australia	Industrial metals & mining
Harmony Gold-ADR	South Africa	Mining
Mechel-Spon ADR	Russia	Industrial metals & mining
Sibanye Gold	South Africa	Mining
Petrobras Ar-ADR	Argentina	Oil & gas producers
Mechel-Pref ADR	Russia	Industrial metals & mining
Drdgold Ltd-ADR	South Africa	Mining
Transport Ga-ADR	Argentina	Oil equipment, services & distribution
Evraz Highve-ADR	South Africa	Industrial metals & mining
WSP Holdings-ADR	China	Oil equipment, services & distribution

Source: Bloomberg, Kepler Cheuvreux

EU regulation: EC voted for final piece in transparency puzzle?

In September 2012, the European Commission voted for tough new legislation requiring payment transparency from the extractives and potentially other sectors. In April 2013 agreement was reached between the European Parliament, Council and Commission that companies with **oil & gas, mining and also forestry (logging)** activity will have to declare a variety of payments made to governments in the countries which they operate. Weaker rules for the banking, construction and telco sectors were also considered but were rejected. This would not, however, preclude inclusion at a future date.

The first step of the EU vote followed shortly after similar legislation passed less than a month prior in the US as a result of the SEC approving Dodd Frank 1504, suggesting that the US had a clear impetus in pushing for the EC reforms. Currently it has been suggested that if agreement is struck between Member States and the EC (and this is by no means certain) implementation could be pending in September 2013 with a further two years for member countries to follow on.

Table 18: Comparison: Dodd Frank 1504 versus proposed EC Transparency directive

	Exemptions for countries that forbid payment disclosure	Project by project reporting	Threshold for declaration	Sectors	Private companies
EC Transparency Directive	No	Yes	EUR100 000	Oil, gas, mining, forestry	Large private companies included
US Dodd Frank 1504	No	Yes	USD100 000	Oil, gas and mining only	No, applies only to SEC listed

Source: EC, SEC, Kepler Cheuvreux

What needs to be reported?

Although the details of the EC rules have not received final approval, they are likely to follow similar requirements to the SEC legislation

Table 19: Proposed EC transparency directive requirements

Production entitlements
Taxes on profits
Royalties
Dividends
Signature, discovery and production bonuses
License fees
Rental fees
Pipeline transit fees
Infrastructure improvements
Entry fees
Other considerations for Licenses/ concessions
Other direct benefits
Payments in kind
Payments to Government Security Forces relating to industry specific activities

Source: EC

Other territories: payment transparency

London Alternative Investment Market (AIM): There is a requirement, for initial listings only, that government payments over GBP10,000 are declared for extractives companies.

Toronto and Hong Kong Stock Exchanges are considering weaker forms of country-by-country level transparency regulation.

Where are extractives companies listed?

Table 20: Over 55% of extractive companies are listed in the US & EU

Exchange/Exchange Group	Total no. of listed companies	Total no. of extractive companies	Extractive sector market cap. (EUR)	% of World extractive sector market cap.
US Exchanges (3)	5 030	503	2 018 375 209 241	32.67%
Deutsche Börse - Frankfurt	--	2 083	685 504 376 580	11.10%
TSX Toronto (TMX Group)	3 894	543	622 869 565 957	10.08%
London SE Group (London and Italy)	2 918	363	572 793 828 258	9.27%
Australian SE	2 019	1 041	306 247 953 498	4.96%
Shanghai SE	921	86	298 392 538 544	4.83%
Johannesburg SE	400	75	264 348 302 430	6.35%
National Stock Exchange India	1 615	153	259 610 594 442	4.20%
BM&FBOVESPA Brazil	377	91	205 798 329 760	3.33%
NYSE Euronext (Amsterdam, Brussels, Lisbon, Paris)	1 133	88	168 325 990 704	2.72%
Sum of non-US extractive sector market cap.			4 159 748 790 021	
Total extractive sector market capitalisation			6 178 123 999 262	

Source: RevenueWatch

The proposed EU regulation follows the US lead but goes further to cover large privately-held companies defined as having two of the following criteria: annual sales >EUR40m, EUR20m in assets, and 250 employees. It also includes "sub-national governments".

As there are an increasing number of emerging market companies in this sector with European and US listings, exchange-led regulation in the US, and EU regulation will either

Large extractives covered **private companies**

push these companies to improve disclosure particularly before listing. The potential effect of certain companies delisting or downgrading their listings from these exchanges seems less likely as the benefits of avoiding transparency would have to be weighed against the potential impact on reputation with investors of such a measure and the lost benefits of increased liquidity, trading and capital raising presence with the most important geographical regions of the global equity markets.

Companies are currently poor in their payment transparency. Even Statoil (which has been one of the best disclosers in this area) is still far from proposed US Dodd Frank 1504 legal requirements and EC Accounting Directive proposals. In a 2012 Transparency International Survey "TRAC", Statoil was indeed the best performer on geographical disclosure. It was notable that even though it was the highest scorer, it received 50% for this criterion.

Table 21: European exchanges and Dodd Frank 1504 reporting

Exchange	Extractives market cap	No of extractives companies	Required to report to SEC	% of exchange
Euronext Amsterdam	878 595 593 000	15	10	66.67
Euronext Brussels	440 811 250 000	40	6	15
Euronext Lisbon	12 823 536 000	2	0	0
Euronext Paris	543 286 765 000	39	9	23.08
Italian Borsa	165 774 731 000	13	3	23.08
London (LSE) Group	1 629 611 606 000	362	13	3.59
NASDAQ OMX Nordic-Copenhagen	116 180 000	3	0	0
NASDAQ OMX Nordic-Helsinki	7 501 540 000	6	0	0
NASDAQ OMX Nordic-Iceland	926 477 000	2	1	50
NASDAQ OMX Nordic-Riga	45 432 000	1	0	0
NASDAQ OMX Nordic-Stockholm	153 085 944 000	28	2	7.14
Oslo Børs	146 544 346 000	68	3	4.41
SIX Swiss Exchange	349 968 793 000	15	5	33.33

Source: RevenueWatch

EITI : Extractive Industries Transparency Initiative

The EITI was the initial impetus for payments transparency, and Dodd Frank legislation models its payment type requirements upon it. The crucial difference is twofold – the EITI is voluntary, and it aims to reconcile payments (not necessarily publicly) declared by corporates with government receipts.

The EITI has been criticised for not always disaggregating payments so granularity can often be lacking in country-level reports. However, the number of signatory countries has increased steadily and, juxtaposed with the US and EC regulations, we believe there is significant strength in the scope of the three transparency efforts together to push for significant changes in overall disclosure levels for the extractives sector.

Beyond any of the three reporting initiatives the question of fair market price is often raised by NGOs and local communities – although payments can be disclosed, doubt is common as to whether market prices are extracted by governments especially in Africa. Contract prices, which are already low, can be further diminished through the routing of payments outside central banks to related entities where government agents siphon off payments. For this reason civil society representatives, particularly within the EITI, have

A threefold disclosure push for extractives between the EITI, the US and the EU...

...but even disclosures cannot ensure fair value transactions

pushed for contract transparency as well as payment and other financial and production data transparency.

EITI investor statement

In February 2013, a large group of global investors signed an EITI Statement pushing for several key principles. Of note is the inclusion of the criteria of "confidentiality" – ostensibly to protect shareholders from losses as a result of potential declarations which could advantage competitors not covered. This remains the key area that would differentiate such a statement from the elements of NGO campaigns. Companies such as RD Shell have been vocal in stating the conflict of interest from their viewpoint in declaring payments against the wishes of host governments.

Table 22: Key EITI investor statement principles

Principle	Reason
Confidentiality	To ensure that existing contractual agreements and commercially sensitive information are respected
Universality	To ensure that improved disclosure standards apply to all parties. This includes joint ventures, state-owned extractive companies and their host governments
Comprehensiveness	Ensuring that all relevant payments and revenues paid to governments are captured
Comparability	To enable data for different countries to be compared easily

Source: EITI

Table 23: EITI country membership

Compliant	CPI 2012	Candidate	CPI 2012
Azerbaijan	27	Afghanistan	8
Central African Republic	26	Albania	33
Ghana	45	Burkina Faso	38
Iraq	18	Cameroon	26
Kyrgyz Republic	24	Chad	19
Liberia	41	Côte d'Ivoire	29
Mali	34	Democratic Republic of Congo	21
Mauritania	31	Gabon	35
Mongolia	36	Guatemala	33
Mozambique	31	Guinea	24
Niger	33	Indonesia	32
Nigeria	27	Kazakhstan	28
Norway	85	Republic of the Congo	26
Peru	38	São Tomé and Príncipe	42
Tanzania	35	Sierra Leone	31
Timor-Leste	33	Solomon Islands	
Yemen	23	Togo	30
Zambia	37	Trinidad and Tobago	39
		Madagascar (suspended)	32
Average	34.7	Average	29.2
(without Norway)	31.7		

Source: EITI, Transparency international CPI 2012, Kepler Cheuvreux I

A good number of countries have joined the EITI...

Table 24: Major gaps: mineral rich emerging markets countries not within the EITI group

Least developed countries		Transition economies
Benin	Saudi Arabia	Belarus
Burundi	Russia	Macedonia
Ethiopia	USA	Republic of Moldova
Lesotho	Iran	Uzbekistan
	China	
	Mexico	
	UAE	
	Kuwait	
	Venezuela	
	Brazil	
	Angola	
	Libya	

Source: World Bank

...but the omissions are very significant...

...and what about all these countries?

Table 25: Largest oil producing countries not in EITI group

Country	Share of world oil production
Saudi Arabia	11,83%
Russia	12,27%
USA	10,67%
Iran	5,01%
China	4,91%
Mexico	3,47%
UAE	3,65%
Kuwait	3,17%
Venezuela	2,92%
Brazil	3,11%
Angola	2,18%
Libya	0,59%
Qatar	1,93%
UK	1,30%

Source: CIA Factbook 2011/ 2012 figures

Table 26: Timing, geographical and content gaps can exist in EITI reporting: ENI S.p.A**Payments* made by ENI to governments of countries that subscribe to the EITI initiative**

Country	Year	Amounts in local currency (in thousands)	Amounts in USD (in thousands)
Kazakhstan (KPO)	2009	13,964,745 (KZT)	96,496
			407,162
Kazakhstan (KCO)	2009	1,611,151 (KZT)	11,133
Norway	2010	7,469,831 (NOK)	1,237,198
East Timor	2009		185,853
Nigeria	2008		1,158,822
Congo	2010	25,357,083 (CFA)	51,248
			112,279
Mozambique	2009	1,735 (MZN)	65

Source: ENI Sustainability Report

Taking the above example with ENI's disclosure of its EITI reporting the gaps are clear – the reporting can be out of date, geographically piecemeal and not be fully transparent or standardised in terms of the aggregated content of payments.

We note in the Appendix the recent results of a Revenue Watch "Resource governance Index (RGI) which identifies four key factors and scores them: "institutional and legal setting", "reporting practices", "safeguard and quality controls" and "enabling environment". Though the scoring clearly involves factors beyond pure corruption risks –

such as that measured in Transparency International's Corruption Perceptions Index (CPI) certain countries within emerging markets perform in the top category "satisfactory" – these include Brazil and Mexico, Colombia, Trinidad and Tobago and Peru which score in the Top 10 of the 58 countries examined.

Country-by-country payments in practice

Overall there are few companies that report payments on a country-by-country level. Where this exists at all, it tends to be in the oil & gas and mining sectors, which will soon be required to report publicly under Dodd Frank 1504. However, the current reporting, not covered by any legal mandate, may not coincide with fiscal periods for financial reporting. Similarly, it may not be subject to audit. We have found no companies that currently report to the level of granularity suggested in Dodd Frank 1504 for country reporting and regarding project-level reporting there are only a handful of names such as Statoil, Newmont and Rio Tinto that disclose any information.

Oil & gas

For this sector, Statoil is a clear leader with the most detailed transparency for all major countries of operation, with a three-year history. However, while this represents the best of current available reporting, we emphasise that the disclosure might still not meet the standards required by US legislation or proposed by the EC, as not all fields are reported to the level of granularity required.

Table 27: Best practice: extract from Statoil country by country reporting

(NOKm)	Investments	Revenues	Purchase of goods and services	Indirect taxes paid	Direct taxes paid	Profit oil in kind	Social investments	Signature bonuses	Pay and social benefit	Number of employees (units)
Algeria	1 691	4 938	29		1 618	2 608	0		26	28
Angola	13 622	13 880	48	2	3 445	24 340	31		15	32
Brazil*	3 878	5 887	4 199	214	**		4		435	174
China	2	-	39		-		0		5	17
Iran	-21	870	35	2	13	2 205	-		13	19
Venezuela	9	1	31	7	-		1		27	36
Eliminations (of intra-group sales)	(182)	(125 634)	(149)							
Total	133 520	670 203	133 727	32 661	117 955	40 438	217	5	30 678	31 715

* A significant part of the investment in Brazil is accounted for in the Netherlands due to Statoil's legal structure.

** Investments include non-cash effects of entering into capital lease agreements and exclude sales of assets.

Source: Source: Statoil 2011

Mining

Anglo American and BG Group provide a level of disclosure that is notable. However, the recent release by Rio Tinto of payments to levels of government below state level sets a benchmark in current reporting. With the passing of Dodd Frank, the levels of granularity we are likely to see are set to rapidly improve over the next two years, as companies first set to position themselves as leaders in such reporting and, as of May 2014, will be mandated to. We believe the most variation will be in the area of project-by-project reporting, as the definitions are still vague and allow considerable interpretation by the companies.

Table 28: Rio Tinto edging toward project level: extract from business unit reporting

(GBPm)	Corporate income tax charge a	Other tax charges b	Total tax charge =a+b	Profit before tax c	Minority interest d	Net earnings =c-a-d
Diamonds and Minerals						
Diamonds	-36	30	-6	-79		-43
Rio Tinto Iron and Titanium	141	43	184	538		397
Rio Tinto Minerals	41	20	61	181		140
Dampier Salt	-3	7	4	-9	-2	-4
Simandou Iron Ore Project		3	3	-324	-62	-262
Copper						
Utah Copper	155	124	279	722		567
Escondida	500	10	510	1314		814
Freeport	-12	1	-11	-29		-17
Palabora	-25	40	15	-11	11	3
Northparkes	58	17	75	202		144

* A significant part of the investment in Brazil is accounted for in the Netherlands due to Statoil's legal structure.

** Investments include non-cash effects of entering into capital lease agreements and exclude sales of assets.

Source: Rio Tinto, 2012

Telecoms

Telefonica demonstrates the greatest clarity by current disclosure practice where key countries of operation have revenues and payments highlighted. This kind of transparency, though still not at the levels proposed by EC regulation, is rare.^{iv}

Subsidiaries: even less transparency

Organisational structure plays a critical role in the ability of both corruption and indeed aggressive (and therefore riskier) tax avoidance to thrive. We note the lack of complete disclosure of countries of incorporation and percent holdings of non-material subsidiaries in the majority of companies analysed. Generally, legal requirements are that "material" subsidiaries be disclosed. However, we would argue that it is the use of non-material structures and indeed shell companies that are put to illicit use and therefore indicate the highest risk of abuse. Visibility of such structures might just mean their disappearance in a number of cases - as their use seems often to be wholly to avoid transparency. The new regulatory emphasis on country reporting has implications for the way that companies are structured - often in order to (usually perfectly legally) create tax avoidance structures.

A recent NGO^v survey of FTSE100 companies found nearly 40% of companies within the index had its overseas companies locate in tax havens (as defined by the NGO). The banking sector was predictably the largest user of such subsidiaries.

Anti-corruption disclosure in EC accounting directive proposals:

Lastly, we note a recent inclusion of anti-corruption reporting within the EC Accounting Directive. The proposal requires companies to report non-financial factors and several aspects of sustainability reporting are included. The criteria do not contain specific KPIs but are to be welcomed as a basis for reporting.

Table 29: EC non-financial reporting proposal includes anti-corruption

EC accounting directives will require a statement containing information relating to anti-corruption and bribery matters	
1	A description of the policy pursued by the company in relation to these matters
2	The results of these policies
3	The risks related to these matters and how the company manages those risks

Source: European Commission Accounting Directive

Subsidiaries and holdings in secrecy jurisdictions remain a major blindspot for investors

Oil & gas

Sector performing well on disclosure, but highly exposed

Table 30: Risk profile for oil & gas

Oil & Gas	
Risk level	Very high
Key factors	Facilitation payments, JVs, consortiums, third-party use, exposure to new revenue transparency laws
Best disclosure	Statoil (A), BP (A), Tullow Oil (A)
Engagement list:	
i) Based on poor disclosure versus geographic risk:	Maurel et Prom (F), Alliance Oil Company (D) and Lundin Petroleum (E)
ii) Based on potential investor impact from allegations:	ENI S.p.A Algeria Sonatrach allegations, ENI S.p.A CEO under investigation, SEC declared investigation in Libya for ENI Total SA - USD 398m settlement in US for Iran, notification of investigations in Libya, Iraq. Fallout in France with CEO in court January 2013 over Iraq allegations

Source: Kepler Cheuvreux

The broad extractives sector scores most highly in the actual number of prosecutions globally, according to a survey by non-profit organisation TRACE, which finds that the sector accounts for just under one-fifth (19.4%) of all prosecutions since the introduction of the FCPA in 1977. We tabulate the highest penalties below as an indication:

Table 31: Fines in the oil & gas sector

Company	Amount (USD m)	Country	Year
KBR/ Halliburton	579	US	2009
Total SA	398	France	2013
Snamprogetti Netherlands B.V./ ENI	365	Netherlands/Italy	2010
Technip	338	France	2010
Panalpina (oil tankers)	81.8	Switzerland	2010
RDSHELL	48	Netherlands/UK	2010
Tenaris	8.9	Italy	2011
Statoil	USD21m, NOK20m	Norway	2006

Source: Newswires, Kepler Cheuvreux

Table 32: Extractives - Oil & gas producers

	Scores					Anti-corruption disclosure criteria				
	Disclosure band (A-F)	Geographical exposure (max=6)	US Dodd Frank reporting	Allegations (A-D)	Risk exposure view (A-F)	Leadership	Risk assessment	Policy	Training	Whistle blowing
Statoil	A	4	X	A	B	A	B	A	B	A
BG Group	A	4		B	B	B	B	A	A	A
Tullow Oil	A	6		A	C	B	A	A	D	A
OMV	C	3		A	C	C	C	B	C	C
BP	A	6	X	A	C	A	B	A	C	A
RD Shell	B	5	X	B	C	B	D	A	B	A
Repsol	B	6		A	D	C	C	A	C	B
Saras	C	4		A	D	D	C	B	E	D
Galp Energia	C	5		A	D	F	B	B	D	E
Essar Energy	C	6		A	D	F	B	B	B	C
Alliance Oil Company	D	6		A	E	F	E	B	E	D
Neste Oil	E	3		A	E	E	E	D	F	F
Lundin Petroleum	E	4		A	E	C	F	D	F	F
Total	B	6	X	D	E	A	C	B	B	C
ENI	B	6	X	D	E	D	C	A	C	C
Maurel et Prom	F	6		A	F	F	F	F	F	F

Source: Kepler Cheuvreux

Table 33: Extractives - Oil services

	Scores					Anti-corruption disclosure criteria				
	Disclosure Band	Geo Exposure	US Dodd Frank reporting	Allegations	Risk exposure view	Leadership	Risk assessment	Policy	Training	Whistle blowing
Amec	B	3		A	B	A	E	A	D	A
CGG	C	6	X	A	D	A	E	B	E	B
PGS	B	6		A	D	B	B	A	C	D
Technip	B	6		A	D	A	C	A	A	C
Tenaris	C	5	X	A	D	C	E	B	D	D
Vopak	C	4		A	D	C	D	B	D	C
SBM Offshore	B	6		C	D	B	B	A	C	A
Bourbon	D	6		A	E	F	C	B	E	F
Saipem	B	6		D	E	C	C	A	C	B
Subsea 7	C	6		A	E	F	D	B	D	C
Tecnicas	E	5		A	E	F	F	D	D	F
Reunidas										
Vallourec	D	5		A	E	D	E	C	C	F

Source: Kepler Cheuvreux

Payment transparency

Although corporates have reservations regarding a level playing field (in that national oil companies and emerging market-listed companies will not be required to follow the same standards) there is, in our view, an increased risk to those companies covered by the new and potential regulations if they have and continue to engage in corrupt payments. The degree of information available may well mean that those interested parties – such as NGOs, local communities and regime changes within governments may well find it easier to uncover the evidence needed that can lead to prosecutions.

Security

Where payments are made and indeed contractually required for security around company assets, we would welcome further disclosure at a project-by-project level. Recent terrorist activities at a BP site in Algeria and pipeline theft in Nigeria from RDSHELL infrastructure have increased the focus on the legitimate requirements of protecting production sites and infrastructure. Where further details are available at a project-by-project level, we believe they can provide insight into the organisation of security and potentially the risk attached. Where companies negotiate state security as "in kind" exchange for example in Production Sharing Agreements this could also be useful information in assessing not only security structures but also corruption risks.

No company discloses country-level payments to standards soon required

Even the best geographical disclosure such as that from Rio Tinto or Statoil falls short of the either the US or EC requirements. The fact that not one company discloses adequately at present is an indication of the level of improvement required in disclosure.

European super majors

All three European super majors Total SA, RDSHELL and BP are exposed to regulation with listings in Europe and the US and a variety of geographically diverse upstream operations. We estimate that all the Super majors will be under scrutiny once Dodd Frank reporting is out in 2014 and the spotlight on any potential illicit payments and the underlying systems to detect and prevent them will be strong.

Summary of major allegations

Total SA

Total SA overall scores a B for transparency, despite some strong policies in a number of areas. However we adjust the overall risk score downwards to "D" – on the basis of the official filings below and the very recent settlement of USD398m in the US for Iran allegations.

Iran

In May, Total SA settled with the US authorities for longstanding allegations of bribes paid in Iran. The gain was said to be USD150m, making the penalty an unadjusted multiple of 2.65x of the gains. The company was also charged in France and Reuters^{vi} contained reports of the French prosecutor calling for a trial of the CEO for the Iran allegations in Paris.

Libya

Another investigation by the US into both Total SA and ENI SpA related to alleged bribery in Libya also declared in the Q3, 2012 SEC filings, but with no specific provisions.^{vii}

"In June 2011, the SEC issued to certain oil companies – including, among others, Total – a formal request for information related to their operations in Libya. Total is cooperating with this non-public investigation."

Iraq

Regarding the UN oil-for-food controversy, the filing states only that "Several countries have launched investigations concerning possible violations related to UN oil for food in Iraq" and goes

on to detail the French investigation. The CEO of Total SA, Christophe de Margerie, attended a tribunal in January in Paris to address questions in a French probe of the allegations. The outcome is not final at the time of writing, and the company and CEO denied the claims of wrongdoing.

Countries of Risk include: Burma, Nigeria, Angola, Venezuela, DRC, Russia

RDSHELL

Of the three European super majors, RDSHELL shows the best whistle-blowing systems with reporting on usage and disciplinary measures.

Specific allegations relate to the NGO Global Witness's claims that both RDSHELL and ENI SpA may have had knowingly structured a deal with the Nigerian government in relation to oil block OPL245 in 2011, to allow for an indirect payment in 2011 to a former Nigeria Petroleum Minister with a conviction for money laundering. Although we cannot confirm the allegations, RDSHELL has attracted particular attention from NGOs for its vocal disagreement with some aspects of payment transparency.

In its 2012 annual report, RDSHELL states:

As a result of the financial crisis, US regulators have adopted regulations that require disclosure of information on payments to governments that we believe is immaterial to investors, but that could compromise confidential commercial arrangements and create conflicting legal requirements. EU regulators have also proposed similar regulations.

RDSHELL^{viii} had a prior conviction related to alleged illicit payments activity in Nigeria for freight forwarding with transportation company Panalpina. The risk here for companies is that they authorise systematically payments which allow for clearance through customs and other regulated channels. The best practice is not only for companies to prohibit such payments, but also to ensure that the potential for such requests is captured in risk management systems and followed up on through official and co-ordinated engagement (with partners and transporters) with authorities.

Countries of Risk include: Russia, Nigeria, Gabon

TNK-BP

BP's troubled history with TNK^{ix} includes an episode reported in the press in October 2012 where it attempted, as TNK-BP, to obtain a "gagging order" against a former head of logistics who claimed to have evidence of wrongdoing involving state agencies against the firm, after he himself was probed regarding the receipt of illicit payments.^x TNK BP has denied the allegations. Although BP scores the most highly among the super majors, with current reporting it is clear that residual and legacy risk in certain countries will remain. Influencing the governance of such partnerships is a significant challenge and may require specific anti-corruption implementation objectives.

BP: demand-side bribery allegations

A BP employee alleged that a senior member of staff accepted cash payments to give preferential terms for the chartering of tankers. As the duration of the alleged activity spanned over five years, according to media reports in March 2012, it is unclear whether certain allegations would therefore fall under the remit of the UK Bribery Act if

investigated officially. There has been no further comment from the SFO (Serious Fraud Office) at this stage. We note that BP has extensive reported policies against such actions within its code of conduct.

Countries of Risk include: Russia, Angola, Iraq, Azerbaijan, Venezuela

ENI and Saipem SpA

ENI SpA could perform better for a company involved in a prior US FCPA settlement for bribery and is under pressure due to a number of allegations currently – whether these prove to be founded or not. Generally, a settlement induces the firm to enhance all areas of anti-corruption risk management and reporting very significantly. Saipem, the ENI subsidiary also involved in the settlement, scores in the same disclosure category – a "B".

ENI SpA and Snamprogetti reached a settlement with the US authorities for a total of USD365m^{xi} in 2010 for a joint venture bribery scheme which extended to Technip SA and KBR in relation to construction contracts in Bonny Island, Nigeria.

Currently allegations include the receipt of bribes via offshore accounts for contracts in Iraq and Kuwait from other services firms, according to Reuters^{xii}. Two of the firms in question, Ansaldo Energia and Ansaldo STS, are controlled by aerospace & defence firm Finmeccanica. This is in conjunction with oil services firm Saipem (43%-owned by ENI SpA).

The CEO of ENI SpA is under investigation^{xiii} by the Italian authorities for alleged bribes paid on behalf of 43%-owned subsidiary Saipem – in Algeria for gas contracts to State-owned oil firm Sonatrach. The total contract value has been quoted as USD 11bn with bribes of EUR 197m paid.

ENI SpA's CEO is said to be directly involved in the illicit payments, but fully denies this. In December 2012, Saipem's CEO had already resigned, COO P. Varone was suspended and ENI SpA's CFO Mr Bernini resigned indicating clearly the seriousness of the allegations.

Major risks include any potential interest from US authorities in pursuing the allegations – if this was the case the ultimate sanctions and penalties would likely be elevated. We note that both ENI SpA and Saipem also have ADRs in US markets. The Department of Justice had already investigated entities of Snamprogetti and ENI SpA in a prior case (involving a prosecution of ENI SpA/Saipem which resulted in a USD365m settlement in 2010 and an agreement to be monitored by US Department of justice for two years on its anti-corruption procedures).

ENI SpA agreed to cover any legal costs when it sold Snamprogetti to Saipem^{xiv}. There has been speculation of ENI SpA selling its holding in Saipem –any M&A activity in this potential future sale involves legal costs and talks regarding possible indemnities with a potential buyer once again if Saipem is sold by ENI SpA.

ENI SpA also faces allegations of bribery in Libya (see section on Total SA for joint allegation & SEC investigation). In Kazakhstan, where an Italian press article speculated the potential suspension of ENI from that country. We have not been able to confirm the allegations^{xv}.

Global Witness had launched specific allegations in November 2012^{xvi} against ENI SpA (with RDSHELL) regarding USD1.1bn payments for oil block OPL-245 in the country routed to the former national oil minister who carries an upheld conviction for money laundering. We would consider that such allegations would readily use payment transparency reporting to support their case. We would also suggest that where companies are readily able to prove anti-corruption due diligence and effective project by project reporting, they are better positioned to refute such allegations.

We adjust the overall risk scores for both **ENI** and **Saipem** downwards to "D" on the basis of the severity of the ongoing allegations (including the probe of the ENI CEO) and potential impact on investors.

ENI Countries of Risk include: Nigeria, Libya, Angola, DRC, Kenya, Ghana, Liberia, Bolivia, Morocco.

Saipem Countries of Risk include: Nigeria, Russia, Angola, Kazakhstan, Mozambique, Venezuela.

BG Group

Alongside ENI, Chevron and Lukoil BG Group have been accused as part of a consortium of using DHL services to make illicit payments to Kazakh customs since 2004. A whistle blowing email was sent in March 2012. Though such payments could potentially be classed as "facilitation payments" without further detail it is impossible to know the exact implications.

Countries of Risk include: India, Kazakhstan, Brazil, Trinidad

Technip and Amec

Both **Technip SA** and **Amec plc** have prior settlements. Technip settled for EUR338m in 2010 in relation to the Nigeria Bonny Island LNG Consortium, and Amec for construction contract allegations in South Korea for GBP4.9m in 2009. Since these settlements, neither company has been the subject of probes or widely reported allegations. As a result, their disclosure scores in the "B" category do not result in any adjustment downwards. We note specific weaknesses however in Technip's whistle-blower policy which scores a "C".

Technip Countries of Risk include: Nigeria, Russia, Angola, Kazakhstan, Mozambique, Venezuela

Amec Countries of Risk include: Brazil, China, South Africa, Mexico

Tenaris

Tenaris SA reached a USD8.9m settlement in May 2011 which included a two-year non-prosecution agreement. For a company with a prior settlement, the company could benefit from further improved disclosure, especially considering the US ADR Listing. However, as part of its prior settlement, stringent conditions for the implementation of anti-corruption best practices were legally required.

Countries of Risk include: Brazil, Argentina

Technip, Tenaris and AMEC have prior settlements

SBM Offshore

SBM Offshore NV has faced controversies after sales practices by third parties were found to be “improper”. To its credit, the issue was found through an internal investigation and created a new board-level position for governance and compliance. However, in April the company issued further information that criminal charges may be a possibility in the Netherlands and the US regarding illicit payments to officials in Africa, stating “*The investigation is expected to be completed in 2013*”^{xvii}

Countries of Risk include: Equatorial Guinea, Angola, Malaysia, Nigeria, Brazil

Tullow Oil

Tullow Oil declares in its recent Corporate Responsibility report that « Allegations of bribery in Uganda, which we first faced and fully defended in 2010, have resurfaced again recently. » In April 2013 the company rejected the allegations in relation to concessions for oil fields in Uganda, stating that « allegations made against Tullow were false and based on forged documents » Within the dossier of evidence^{xviii} presented publically by Tullow were statements from London Metropolitan police supporting the forgery claim and an email from the SFO detailing a decision not to investigate further. On the basis of the background of the claims - which emerged through a tax dispute with Heritage Oil, the arguments presented publically by Tullow to refute the claims and a background of best practice in reporting both on anti corruption systems and country by country payment disclosure we have not reduced the company's scores within the allegations criteria.

Countries of Risk include: Ghana, Gabon, Equatorial Guinea, Congo Brazaville, Mauritania, Bangladesh, Pakistan

Mining & metals

Table 34: Risk profile for mining

Mining	
Risk level	Very high
Key factors	Facilitation payments, JVs, third-party use, exposure to new revenue transparency laws, potential government-linked beneficial owners of entities to which payments are made, China exposure
Best disclosure	Anglo American (A)
	Rio Tinto (A)
Engagement List:	
i) Based on poor disclosure versus geographic risk:	Glencore (F),
ii) Based on potential investor impact from allegations:	ENRC - UK SFO investigation into Kazakh allegations with ongoing governance impact
	BHP Billiton – SEC declared FCPA statements mean ongoing impact still a possibility despite excellent disclosure

Source: Kepler Cheuvreux

The sector has been highly exposed to risks from business ethics violations, and will be required to adhere to both US Dodd Frank regulations and EU regulation. The sector is likely to be subject to continued NGO pressure in terms of payment transparency and fairness to local communities.

Several global players stand out as performing well on disclosure and some companies have begun reporting on country-level payments.

Country risk: What matters more – asset or revenue exposure?

We highlight countries of risk according to both known asset and revenue exposure. Though companies in the extractives sector are exposed to corruption risks in the acquisition and renewal of their assets, we note key revenue markets have the potential to increase risk also. An example is BHP Billiton's recent controversies regarding its sponsorship of the Beijing Olympics. We also note that current projects (often with JVs or minority owned subsidiaries) in development also present an element of risk and key countries are noted herein also.

Glencore scores at the bottom of the overall group we studied – however, in the years since its listing, there have been significant improvements in overall disclosure. The merger with Xstrata would pose very large challenges in extending some of Xstrata's best practice leadership in the area within the combined entity. Reputationally, Glencore has suffered a number of allegations related to potentially illicit payments and aggressive tax avoidance in some of its key production markets. It remains very weak in transparency concerning both anti-corruption systems and payment transparency.

Table 35: Extractives: Mining & metals

Scores						Anti-corruption disclosure criteria				
Disclosure (A-F)	Geo Exposure (max=6)	US Dodd Frank Reporting	Allegations (A-D)	Risk exposure view (A-F)		Leadership	Risk assessment	Policy	Training	Whistle blowing
Arcelor	B	4	X	A	B	B	A	A	C	C
Rio Tinto	A	5	X	B	B	A	A	A	B	A
Anglo American	A	6		A	C	A	A	A	A	A
Norsk Hydro	B	5		A	C	F	B	A	B	A
Boliden	C	4		A	C	E	D	B	D	C
Antofagasta	C	4		A	C	F	C	A	D	B
BHP Billiton	A	5	X	D	D	A	B	A	D	A
Xstrata	B	6		A	D	A	B	A	C	B
Areva	C	4		A	D	D	E	A	D	D
Eramet	E	4		A	F	F	F	D	E	F
ENRC	C	6		D	F	F	B	A	C	D
Glencore	F	6		B	F	F	F	E	E	F

Source: Kepler Cheuvreux

Summary of major allegations

Rio Tinto

Four employees were found guilty of accepting an alleged total of UDD13.5m in corrupt payments in China. As an example of political risk – there were related allegations during the case of using secret information to manipulate iron ore prices. There were also counter allegations that the Chinese government was retaliating against Rio Tinto's rejection of a USD19.5bn investment by the Chinese.^{xix} FY 2012 China revenue was reported at EUR17,948m or 32.3% of total.

As a case where Rio Tinto has felt the impact from operating in a region where corruption is high, we note the case in Guinea regarding the large deposits of iron ore at the Simandou site. In 2008, half of Rio Tinto's rights were withdrawn by the government on the basis that it had not met deadlines for production. No corruption was alleged on the part of Rio Tinto, and the company denied allegations of missing targets. Another operator, Beny Steinmetz Group, purchased the rights lost by Rio Tinto for USD160m, which it later sold to Vale for USD2.5bn. Former Secretary General of the UN Kofi Annan's Africa Progress Panel^{xx} states explicitly that contract transparency in such a case would have benefited all stakeholders - including investors.

We emphasise that no corrupt activity was alleged on the part of Rio Tinto – however, an employee and advisor of BSGR were recently arrested in relation to these allegations^{xxi} and a US Department of Justice probe.

Rio encountered allegations^{xxii} from the anti-corruption agency of the country in its Mongolia subsidiary SouthGobi in 2012, but the company was not prosecuted. A lawyer working on behalf of Rio was barred from leaving the country in 2012.

Countries of Risk include: China, Indonesia, Mongolia

A lack of transparency creates an environment of long term operational instability

Glencore

Glencore has encountered a variety of allegations related both to bribery and aggressive tax avoidance. We note the second area as in the long term with EC country-by-country reporting regulation, a company such as Glencore would be under particular scrutiny for its corporate structure and the potential aggressive use of transfer pricing which allows companies to declare profits in lower tax jurisdictions to lower the overall effective rate.

Global Witness^{xxiii} has revealed investigations related to Glencore's DRC operations and links with controversial middle man Dan Gertler. It specifically states that, in its opinion, there is a risk of Glencore's involvement in corruption due to the way that large government stakes were sold in secret. The specific risk is that Glencore's shareholders are exposed to any regime change from the fragile position of the DRC state, should a future government decide to jeopardise/renege on any prior contracts perceived to be the result of corrupt agreements.

In June 2012, a grain trading subsidiary of Glencore was accused of bribing EU officials for sensitive information related to export subsidy applications. The ultimate fine was from Belgian courts for the amount of EUR500,000 and the bribes related to alleged mobile phone bills of EUR20,000 and a holiday in France given to an EU official to facilitate the exchange of confidential and regulated information.

In relation to country-by-country reporting, Glencore already faces considerable demand for such data from issues in relation to allegations of aggressive tax avoidance. For example, the NGO "Publish What You Pay" maintains that over half of Glencore's subsidiaries are incorporated into tax havens^{xxiv} Glencore International AG is the most opaque mining company in the survey with 46% of its 46 subsidiaries incorporated in secrecy jurisdictions.

"This is relevant given information contained in Glencore's recent listing document which confirms that its effective tax rate for its 2010 USD234m tax bill, 'was 9.3% compared to 12.6% for 2009' on revenues of USD144.9 billion and profits of USD4.1 billion."

Derivatives have also been the subject of tax planning controversies, with the possible use of internal derivatives accounting within Glencore to result in losses in certain territories to facilitate lower final taxation.^{xxv} This is not held to be illegal in any way, hence the risk is rather additional reputational damage and the possibility that future governments will legislate to close such loopholes being used to facilitate tax avoidance. Glencore itself fully denies the allegations and maintains that the use of derivatives here is a risk management tool. We highlight these allegations as payment transparency regulation is likely to fuel interest in these kinds accusations and create a set of tools whereby they may be better supported.

Countries of Risk include: Zambia, Iran, Bolivia, DRC, Kazakhstan, Russia, Columbia, Philippines

NGOs want more transparency over Glencore's activities in the DRC...

...going forward we think investors would benefit also

Country-by-country reporting may amplify scrutiny over Glencore's tax payments

BHP Billiton

BHP Billiton has suffered allegations originating in the Australian press recently, related to hospitality during the Beijing Olympic games where it held a high-profile campaign of "stakeholder leveraging" in China, following its bid to become the "diversified minerals and medals" provider for the 2008 games.

It had declared its cooperation concerning unspecified allegations with the US authorities in a 2010 statement, on certain "terminated minerals exploitation projects". Media reports have suggested enquiries related to Cambodia^{xxvi} and the Philippines^{xxvii}. The UK SFO had also made an assessment into the company in 2010. The company reports in the US as it has the highest level US listing for a foreign company – (Level III American Depositary Receipt). The final risk performance score has been reduced to "D" due to the SEC filings noting potential FCPA events, however the commitment excellent disclosure serves as a positive forward looking indicator. FY2012 China exposure was reported at EUR21.6bn or 30% of total revenue.

Countries of Risk include: China, South Africa, Pakistan, Brazil, Columbia, Trinidad, Peru

ENRC

ENRC continues to suffer fallout from repeated corruption scandals and the overall concerns with corporate governance which persist around the bribery allegations. The UK Serious Fraud Office launched an official investigation into ENRC in April 2013 over allegations related to Kazakhstan and Africa. In the same month, the Financial Times also ran a story related to potential whistle-blower allegations within the company and reported the suspension of a manager in Mozambique. The newspaper also reported the departure of an ENRC corporate investigator amid claims that he had received threats regarding potential investigations of Kazakh operations.

The law firm which had been hired to investigate corruption allegations had also been dismissed. We have lowered the overall performance score due to the SFO investigation and the numerous credible concerns which have been publically aired.

Brokers Morgan Stanley and Deutsche Bank also resigned in May 2013 surrounding the overall corruption and governance scandals.

A widely cited^{xxviii} report released by Kofi Annan's Africa Progress Panel criticised ENRC specifically for costing the Democratic Republic of Congo USD725m. Of the five undervalued mining assets cited, three involve ENRC transactions.

Countries of Risk include: Russia, DRC, Kazakstan

UK Bribery Act, miners & facilitation payments

We were unable to find explicit publicly disclosed statements forbidding facilitation payments from Glencore (UK Listing now Glencore Xstrata Plc) and Boliden (2012 UK Revenues 21.1% or 8,440m). The UK Bribery Act is clear in defining the illegality of such payments for those companies with UK connections.

Forestry and logging: more scrutiny coming

The sector has been subject to varied EU legislation recently, aimed primarily at reducing illegal logging. Country-by-country reporting is seen by some as a natural extension of the transparency already mandated in terms of responsible disclosure to enable all stakeholders to assess the variety of ethical, geopolitical, reputational and environmental risks that surround this sensitive sector.

Table 36: Risk profile for forestry

Exposure level	Medium but expected to increase as EC Rules implemented
Key risks	Land Tenure Rights, emerging markets licensing and permit payments, exposure to new revenue transparency laws, potential government-linked beneficial owners of entities to which payments are made
Best disclosure	No A grades awarded: Stora Enso (B), SCA (B)
Engagement List :	Sector has not had the scrutiny or level of controversies/ investor impacts compared to other extractives sectors Based on below average disclosure: Mayr-Melnhof Karton AG (E) , Metsa Board (D), Billerud (D)

Source: Company reports, Kepler Cheuvreux

The sector has been under increased regulatory scrutiny with for example the recent **EU Timber Act**, which came into force on 3 March 2013. This law forbids the placing of illegally harvested timber and derivative products on EU markets. It applies both to domestic and exported timber. The law bears many similarities to the US Lacey Act and effectively sets a standard for developed markets trading.

In the scoring system below, we note the greater uniformity of the overall final score. Due to the lack of allegations leading to probes and penalties for companies in this sector, as well as less variation in transparency we have not highlighted companies that would be critical candidates for engagement as we have with the other extractive sectors. However, the table of sub criteria forms a valid table for looking for areas of engagement in terms of disclosure. *No company scored a Grade A in this sector.*

Table 37: Extractives: forestry

Paper & forestry	Scores						Anti-corruption disclosure criteria				
	Own Forests	Standing timber	Disclosure (A-F)	Geographic exposure (max=6)	Allegations (A-D)	Risk exposure view (A-F)	Leadership	Risk assessment	Policy	Training	Whistle Blowing
SCA	x		B	4	A	C	C	A	C	C	C
Stora Enso	x		B	4	A	C	C	B	A	C	C
Smurfit	x		C	3	A	C	B	D	B	D	D
Ahlstrom		x	C	5	A	C	D	B	B	C	C
Holmen	x		C	3	A	C	C	B	A	C	F
Norske Skog		x	C	3	A	C	E	E	A	D	C
UPM Kymmene	x		C	4	A	D	F	E	B	B	B
Billerud		x	D	4	A	D	D	D	D	C	C
ENCE	x		F	2	A	D	F	F	F	F	F
Mayr-Melnhof Karton		x	E	4	A	E	F	F	D	E	E
Metsa Board		x	D	4	A	E	C	D	C	D	F

Source: Kepler Cheuvreux

Corruption can fuel land right disputes - central ESG issue for sector

Stora Enso and SCA provide the best disclosure, but they are also faced with more exposure to markets in which corruption is more common. Stora Enso has faced local resistance from its Veracel joint venture in Brazil, which included allegations^{xxix} that a local government official was bribed to vote for favourable laws for the company. In common with all companies operating in these regions, there is a specific risk of being caught up in land right disputes in which bribery plays an integral role. China has also seen such allegations where local officials may be complicit in corrupt actions such as compensation and land rights revenue^{xxx}.

SCA scores a B grade overall, with stronger transparency regarding integration of risk assessments, but greater disclosure in all areas would be welcome. The main focus of is China (where a primary corruption risk resides) and Latin America. Stora Enso, is typical of many companies looking for a lower cost base in China.

Among those companies that do not own forests, but buy "standing timber" (the option right to harvest trees during a fixed period), Mayr Mehlhof and Ahlstrom show operational exposure to emerging markets. In Scandinavian countries, the deals are predominantly restricted to private-sector owners of forests, so are unlikely to be reported. Other countries, such as Russia, may require government negotiations, so levels of risk related to potential corruption will again vary by country - a further reason for which country-by-country disclosure is highly relevant. According to our analyst, Mayr Mehlhof is looking to reach a sales growth target of 25% originating outside Europe.

The sector has avoided the same level of pursuit by regulatory authorities as the other extractives. However, some of the resource-rich countries in which the forestry sector operates have clear challenges in terms of avoiding corrupt payments. Certain NGOs also argue that the criticality of the sector avoiding corruption is paramount as deforestation is systemic and a global issue, with bribe payments accelerating the destruction.

In Equatorial Guinea, the corrupt payments allegedly accepted by the President's office were perpetuated through the national forestry department, which was owned by the President himself.

The sector tends to have less visibility than its oil, gas and mining peers, with the size of both the listed companies and global deals smaller and less conspicuous. Governments themselves have also tended to be less vocal in fighting forestry sector corruption.

Another area of corruption outside the direct scope of the report is corruption related to carbon credits in mechanisms such as REDD – the direct circumventing of the administrative parameters surrounding accounting rules, emissions disclosures and baselines.

Land rights are also a key area in which bribery occurs, with companies either acquiring land at below market value through illicit payments and bypassing the land rights of local communities and individuals. However, such cases have proven difficult to prosecute internationally. Strong implementation of anti-corruption systems will, in our view, diminish the amounts of illicit payments from companies in this sector. Greater disclosure of country- and project-level payments may in the long term also reduce the ease with which such payments can be hidden and therefore reduce the corruption sourced from companies covered by such regulation.

China can mean revenue growth, a lower cost base and.... increased exposure to corruption risks

"Standing wood"

Forestry sector bribes have environmental consequences

Banking: all aboard for 2015?

Banks as a sector have faced the most sustained controversies in the past five years. Though actual bribery itself is less common within the banking system than other sectors, financial services are central to the risk that bribery presents to investors as they can facilitate potentially illicit payments through the transaction and laundering of bribe money without effective due diligence. Furthermore, we look at bribery as a problem that is central to sustaining other forms of corruption, such as the LIBOR rate collusion. Lastly, though rare, bank employees can be on the receiving end or “demand side” of bribes to facilitate restricted services.

We have not scored banks on risk exposure due to the specificity of the risks faced which differentiate financial services from the other sectors in this report.

Table 38: Risk profile for financial services

Risk level	Medium risk for bribery, Anti Money Laundering violation is the major risk
Key risk factors	Bribery used to aid money laundering or insider trading. (i.e. KYC). Accounts used for “slush funds”, wire transfer services used for illicit payments, Risk of insufficient due diligence in M&A transactions. Increase in allegations on activity in Middle East. Use of intermediaries. Routing of offshore transactions, “shell” companies
Best protected	Among the major banks, there is a minimal variation in the anti-corruption systems allowing differentiation to remain difficult
Highest risk	No bank shows significantly higher risk than its peers, based on available news flow and reporting

Source: Company reports, Kepler Cheuvreux

Table 39: Bank Sector Disclosure Scores

	Disclosure (A-F)	Leadership	Risk Assessment	Policy	Training	Whistle blowing
BNP Paribas	B	C	C	A	B	C
Santander	C	E	C	B	D	C
Barclays	C	E	E	A	D	D
UBS	B	A	B	A	C	B
BBVA	C	C	E	B	D	D
CS Group	C	F	B	B	D	C
Nordea	B	B	C	A	A	D
Deutsche Bank	C	F	D	B	C	C
Unicredit	C	C	D	B	D	C
Societe Generale	C	C	E	B	C	D
Intesa-Sanpaolo	D	E	F	B	D	B
Svenska Handelsbanken	E	D	E	D	E	F
Danske Bank	C	E	C	B	D	B
Caixabank	D	E	C	D	E	E
Commerzbank	C	B	B	B	C	C
Banco Popular	C	D	C	B	D	C

Source: Kepler Cheuvreux

Not much differentiation between the companies

As the table above shows, the majority of companies fall under the middle score of a “C” – there is little differentiation among players. Best practice is particularly difficult to identify,

and in our view, the sector continues to be at risk reputationally and financially from a variety of practices ranging from involvement in territories with political risk (ie sanctions). Geographic data is more sparse in this sector, and the per cent revenues, and full list of “offshore” secrecy jurisdiction entities would further help us to assess corruption risk.

The list of potential corruption violations for the financial services sector is long and we believe country-by-country reporting can provide critical additional resources for shareholders to assess a variety of risks and fuller potential impacts of any current controversies. The US Dodd Frank Act does not mandate country-by-country disclosure for the banks sector, it has, however, been proposed by the EC and reinforced in recent amendments to the Capital Requirement Directive (CRD IV).

Banks have suffered considerable reputational damage during the financial crisis, but have largely been void of major scandals related to bribery. According to the Transparency International Bribe Payers Index it is within the financial sector that there is the biggest differential between perceptions of low level, low value and routine bribes paid and high level bribery or “state capture”. As a highly-regulated industry, direct operational forms of bribery are rarer here than industrial sectors. However, bribery has been alleged within a variety of other allegations, such as the LIBOR rate collusion.

A major risk for the sector is complicity by allowing accounts and services such as transfers to be used in the bribery process without adequate due diligence. Legally, the risk here is money laundering, but reputational damage is also a risk through association with corrupt entities.

We note also that, as an industry, disclosure on anti-corruption systems and policies is poor vs. other sectors.

Banks are perceived as having exposure to high-level corruption

Know your customer

Table 40: Bribery in financial services

	Example	Institutions allegedly involved
Collusion - Rate manipulation	Bribes paid between traders to maintain LIBOR rate manipulation	UBS, RBS ^{xxxi}
Capital raising	Use of external brokers for sovereign wealth funds negotiations	Barclays, alleged payments of GBP238m to Qatar Investment Authority ^{xxxii}
Acquiring official financial activity licenses	Obtaining Saudi banking licence	Barclays ^{xxxiii}
KYC process - Fraud	Use for criminal fraud by Stanford, Account (slush fund) used to bribe Antiguan Regulator	Société Générale ^{xxxiv}
KYC process - Processing bribe money	Al Rushaid launch suit for USD350m after parts failed to arrive and delayed the completion of contracts	Pictet ^{xxxv}
KYC process - Not reporting ultimate beneficial owner	UN Sanctions, Iraq Oil for Food Programme	BNP Paribas ^{xxxvi}
Insider Information	Galleon Group : - paying bribes for insider information	Galleon Group ^{xxxvii}
Market manipulation/ False trading	Hong Kong Manager of derivatives accepted bribes to advise on trading of derivative warrants	Employee of Deutsche Bank ^{xxxviii} (Deutsche Bank NOT implicated)

Source: Newswires

Beyond Dodd Frank: already exposed to country risk

Table 41: US regulation with extraterritorial scope

Bank Secrecy Act	BSA
International Emergency Economic Powers Act	IEEPA
Trading with the Enemy Act	TWEA

Source: US Department of Justice

The three acts above have been passed by the US in recent years and all pose risks for the vast majority of banks which operate globally and require some interaction with US financial systems. With any potential country-by-country reporting from banks, the visibility of exposure to such regulation may be increased. A direct consideration for investors is therefore overall compliance structures.

The former UK Financial Services Authority (FSA) conducted a review into Bribery and Corruption Risk Management controls in investment banks in March 2012^{xxxix}. It visited 15 firms including eight major global investment banks. The major findings included

- Most firms had not properly taken account of our rules covering bribery and corruption, either before the implementation of the Bribery Act 2010 or after.
- Nearly half the firms in our sample did not have an adequate ABC risk assessment.
- Management information on ABC was poor, making it difficult for us to see how firms' senior management could provide effective oversight.
- Only two firms had either started or carried out specific ABC internal audits
- There were significant issues in firms' dealings with third parties used to win or retain business.
- Though many firms had recently tightened up their gifts, hospitality and expenses policies, few had processes to ensure gifts and expenses in relation to particular clients/projects were reasonable on a cumulative basis.

Litigation provisions take the market by surprise

In February, Société Générale set aside a litigation provision of EUR300m for costs that were not explained. Deutsche Bank this year raised overall provisions to EUR2.4bn versus EUR1.8bn due to "*new developments related to specific existing legal matters*" that occurred after the bank reported preliminary 2012 results on 31 January. The Financial Times reported that Deutsche Bank set aside EUR500m to cover potential LIBOR costs.

While the LIBOR manipulation is a form of corruption, we emphasise that bribery has been directly alleged to maintain it. As for secretive abuses of power, using corporate assets, we would expect both rate manipulation and bribery to be covered by a code of conduct.

Summary of major allegations

A **Société Générale** account was allegedly used as a **slush fund** by Stanford Financial Group's ex-CFO for personal expenses and bribes including illicit payments to the Antiguan regulator. The Stanford Group was accused of a USD2bn fraud wherein customer funds were diverted. The amount deposited with Société Générale was said to be USD130m.

In May 2013, the CEO of Societe Generale's Russian unit Rosbank was arrested for allegedly accepting USD1.5m in bribes for granting a loan and lowering the interest rate^{xi}. Deloitte was appointed to investigate the transactions and the bank moved to dismiss the CEO according to the Wall Street Journal^{xli}.

BNP Paribas

The bank handling all transfers for the USD64bn oil-for-food programme was BNP Paribas New York. A US investigation concluded the bank made payments without adequate due diligence and estimated it received a total of USD700m in fees between 1996 and 2003 under the programme. No charges were presented against the bank, which denied all wrong-doing.

The NGO Sherpa alleged^{xlii} BNP Monaco of lax procedures on money laundering in relation to activity in Africa. BNP Paribas has since closed several accounts and increased risk controls.

In 2007 the FT carried an allegation^{xliii} that a Shanghai employee had bribed a senior official in order to gain sovereign debt underwriting contracts for a payment of USD128,000 in the late 1990s. The bank was not charged or officially implicated.

HSBC

An HSBC employee of the broking services division for Asia was jailed for one year in 2012 for accepting advantages of HK1.1m to assist a client with buying a 10 million tranche of shares in a listed company^{xliiv}. HSBC was not accused of wrong-doing or charged. As with several of these allegations, the key risk is reputational, through association with the reported wrong-doing of employees.

However, in relation to money laundering, HSBC has experienced the largest penalties of any peer amounting to USD1.9bn for a variety of allegations – bribery was not explicitly within the settlement but ***we would remind investors that there is exposure to laundering illicit proceeds of corruption within any systematic failure of anti-money laundering controls.***

Deutsche Bank

A Hong Kong Director of Deutsche Bank was charged with taking bribes to the value of USD3.2m in January 2012 in return for advice on trading derivative warrants issued by the bank. No charges were brought against the bank and Deutsche maintained: *"This is a personal matter for Mr Ma. There is absolutely no suggestion of any wrongdoing by Deutsche Bank."*

Slush fund at Société Générale

Russian CEO arrested

Alleged lack of due diligence for Oil-for-Food Programme

UBS

A Royal Bank of Scotland (RBS) trader worked with a counterpart at UBS AG to pay approximately GBP211,000 in bribes to brokers to propagate collusive rate collusion manipulation^{xlv}

In March 2013 the Wall Street Journal^{xlvi} carried an article citing allegations during a litigation from a Kuwaiti sheik, who accused the company of offering a USD 20m bribe in order to obtain an advisory role in the sale of Telecom assets of the national operator Zain. The trial is due to commence June 2013. UBS denies all claims of wrong doing.

Nordea AB

Nordea received a SEK30m (EUR3.5m) fine related to insufficient anti money laundering procedures.

The allegations^{xlvii} were tied to a customer linked to TeliaSonera bribe payments. Remedial action included new due diligence measures after the freezing of the account. The case illustrates the multiple impacts of bribery which can extend not only to the loss of shareholder value and reputation of the initial company involved but increasingly can have a regulatory and reputation impact on those financial service providers that have not committed illegal acts but are found to be associated to the guilty parties after a lack of due diligence. Nordea stated in a press release that it *"finds the penalty large since no prohibited transactions whatsoever have been made on the frozen accounts"* and has since introduced more stringent controls and due diligence.

Morgan Stanley - the key case to remember

A landmark case judgement was reached in April 2012 when the US authorities exonerated Morgan Stanley from corporate liability for illicit payments surrounding a senior employee based in their Real Estate Division in China. The Department of Justice and SEC explicitly praised^{xlviii} the company for a variety of specific internal controls related to the US FCPA anti-bribery laws. The individual was fined USD 250,000 and is undergoing further investigation.

Bank fully exonerated from penalties due to sound anti-corruption controls

Insider trading and bribery

Some cases of **insider trading** have depended on bribes to generate information. In the largest ever hedge fund insider trading ring, involving the Galleon Group, frequent illicit payments to corporate lawyers to obtain non-public information were allegedly made and acted upon.

Insurers received the largest UK penalties

The former UK **Financial Services Authority** issued its **two largest ever penalties** to insurance companies Aon and Willis in recent years. Both involved payment of bribes to foreign officials and, in the case of Willis, charges were made for the company's failure to prevent the actions (i.e. inadequate anti-corruption systems).

Allianz recently (December 2012) settled a US case for USD12.4m, based on allegations of improper payments in Indonesia to gain access as insurer for large government projects from 2001 through 2008. USD5.3m of this penalty was a "disgorgement" or return of profits gained from the alleged bribery, a further USD5.3m was a penalty and interest a

further USD1.8m. An internal audit in 2005 found evidence of bribery but was allegedly not acted upon. Whistle blowing in 2009 led to the final investigation from the company. Allianz has however introduced a variety of anti-corruption procedures. A 2012 survey by Transparency International (TRAC)^{xlix} gave Allianz a high score of 88% for anti-corruption procedures disclosure.

Sovereign wealth funds pose a risk

Fees paid to **sovereign wealth funds** are the source of SEC investigations^l against Bank of America Merrill Lynch, Morgan Stanley and Citigroup regarding the payments to "placement agents" to gain business with sovereign wealth funds, which may not bode well for European banks with UK-related activity with SWFs.

Press articles^{li} have cited Société Générale's activities with the Libyan Investment Authority as being placed in doubt by the country's new authorities. Société Générale is said to be the largest European holder of Libyan funds primarily through structured products at USD1bn. However, no final rulings have yet been reached.

The NGO Global Witness has called for greater transparency by banks holding state-owned funds, on the basis that these are ultimately owned by the nationals of the country. It has also pushed for greater due diligence checks in sovereign-owned assets to ensure they are not transferred to rulers themselves.

Private equity is also under increased scrutiny. With majority holdings and management involvement, private equity can have far greater accountability for its investments. Investors posed numerous questions to CVC Capital Partners following public coverage of the corruption surrounding its Formula One stake.

The Wolfsberg Principles propose guidance on anti-corruption within the financial sector and currently 11 major global banks are members. The principles treat anti-money-laundering and terrorist financing. We would emphasise that merely being a signatory to the Principles has not correlated to improved performance in anti money laundering.

Table 42: Wolfsberg Group of banks

Name	UN Global Comp	Region	Country	UN PRI Member
UBS	Yes	Europe	Switzerland	Yes
JPMorgan Chase & Co.	No	US	US	No
Banco Santander SA	Yes	Europe	Spain	No
Bank Of Tokyo-Mitsubishi UFJ	No	Japan	Japan	No
Crédit Suisse Group	Yes	Europe	Switzerland	No
HSBC Holdings Plc.	Yes	Europe	UK	No
Citigroup Inc.	No	US	US	No
Société Générale	Yes	Europe	France	Yes
Barclays Plc	No	Europe	UK	No
Deutsche Bank	Yes	Europe	Germany	Yes
Goldman Sachs Group Inc.	No	US	US	No

Source: Bloomberg

Money laundering is the central risk for financial sector exposure to bribery. Know Your Customer (KYC) rules need to be strictly enforced to avoid complicity by financial services firms in acts of bribery.

Elements of highest risks for sector according to Wolfsberg guidance

- **Services risk:** International money transfers, some countries such as the US have specific statutes for wire fraud crime often used to prosecute in bribery cases.
- **Country risk:** Offshore facilities, countries with authoritarian regimes and a lack of rule of law. Also the risk of breaking embargos/ sanctions rules.
- **Customer risk:** PEP – Politically Exposed Persons, their family and close associates.
- **Transaction risk:** The setting up of investment vehicles such as trusts or foundations. The Wolfsberg Group questionnaire asks banks if they have a policy prohibiting accounts/ relationships with "shell banks" - those in which they have no physical presence and are unaffiliated with a regulated financial group.
- **Cash transaction reporting:** Banks should have procedures to specifically identify transactions structured to avoid triggering such reporting also.
- **Fee structures:** "Success fees" and bonuses where there is lack of documentation on true services carried out.

The forensic accounting trail within corruption cases will usually lead to banks used for servicing the bribes, which may have implications as to the jurisdiction of the prosecuting authorities. However, the Wolfsberg Principles do qualify the responsibility of the banks themselves in this role; *"Responsibility must rest with customer or customer's representatives, particularly as a financial institution will seldom have a complete overview of the customers transactions"*.

Key recommendations specific to the industry include:

- **Establishment of a control environment** – due diligence when engaging third parties, and inclusion of anti-bribery provisions and warranties in contact with third parties.
- **Due diligence of corruption risks** within any M&A activity where the firm is acting as principal not merely advisory capacity.
- **Gifts and entertainment:** As hospitality and gifts are common within the sector, specific guidelines are advised – these should include maximum monetary limit values and explanations of common conflicts of interest and how they should be handled. Even within different divisions of a large bank there may be variations on thresholds of acceptability – private banking/ wealth management units may carry significantly higher gift limits where the high net worth clients are involved and this is considered an acceptable norm.
- **Charitable donations:** Prominent and high-value philanthropic associations are common. However, conflicts of interest may arise where foundation board members or heads of charitable groups have associations with the bank.
- **Political donations:** While the area of direct political donations has standard legal limits, lobbying or the payment for access to political decision makers is still legally a grey area. It remains marked by a lack of transparency.
- **Whistle blowing:** Banks are required under securities regulations such as Sarbanes Oxley to implement some kind of whistle-blowing system.
- **Hiring and internship practices:** Specific allegations of nepotism are common in the sector particularly for internships and guidance is advised to avoid using hiring practices in return for client activity.

Global bribe payments depend on lax due diligence by companies and banks

Risks associated with handling bribe money are intrinsic in bank's anti money laundering control and detection systems

Banks had been proposed for inclusion in EC Transparency regulation but this was not passed, with the emphasis remaining on the extractives sector for this Directive. However, within another financial-services-specific regulatory proposal in the Capital Requirement Directive (CRD IV), country-by-country reporting has been proposed. It looks for banks to report to the EC in 2014 when further consideration will be made as to potential impact and implications – harm to competitiveness before any final public disclosure starting potentially in 2015.

**European banks
reporting country level
data by 2015?**

Table 43: EC transparency proposals: banks (capital requirement directive – CRD IV)

1	Profits
2	Taxes paid
3	Subsidies received
4	Turnover
5	Number of employees

Source: EC

In April, French banks were called upon to increase the disclosure of subsidiaries and further data such as employee numbers, following a government scandal involving a French minister using a Swiss account to avoid paying taxes. French banks already disclose subsidiary names and locations. This action was not aimed at bribery, but will indirectly increase overall transparency of structures, thus potentially decreasing the ease with which offshore sites and secrecy jurisdictions can be used for any secretive purposes including holding corrupt proceeds.

Widespread use of offshore centres

As banks facilitate the flow of capital, their use of secrecy jurisdictions has significant ramifications for a number of stakeholders. Governments have increasingly pursued banks themselves and not just final end-users of tax avoidance mechanisms. Such has been the case of the US pursuit of UBS, Wegelin and other Swiss banks and also Barclays' clients in their tax planning products.

**Tax avoidance and
money laundering are
synonymous with
"offshore"**

Money laundering is another area of risk for banks where regulators – especially the US – have been increasingly aggressive. Although these violations will not always involve offshore transactions – the use of secrecy jurisdictions has been implicated in certain Anti-Money Laundering (AML) cases in which clients have been aided by banks in avoiding being revealed as beneficial owners for assets potentially the subject of legal enquiries.

Public statements and reputational impact: Standard Chartered

As part of the agreements with US authorities, companies are not allowed to make public statements contesting the settlements. This has ramifications for them reputationally – during the period of the settlement – often three years – the company itself can be prosecuted for publically denying any responsibility. Until recently, examples of a company challenging this were rare, but, with the recent Standard Chartered case for sanctions violations, a clear precedent was set showing the near impossibility for companies to circumvent this part of the settlement agreement. The risks for corporate reputation therefore are significant and increased.

The Chairman of Standard Chartered had stated in a press conference when asked about sanctions violations that *"no wilful act to avoid sanctions; you know, mistakes are made – clerical errors"*. However, after a meeting with regulators soon after was forced to issue an official exchange announcement *"My statement that Standard Chartered 'had no wilful act to avoid sanctions' was wrong, and directly contradicts Standard Chartered's acceptance of responsibility in the deferred prosecution agreement and accompanying factual statement."* We emphasise this issue as anti-corruption settlements of any kind in the US are likely to contain such provisions.

Telcos

Table 44: Risk profile for telcos

Risk level		High
Key factors:	Foreign licensing process, holdings companies, regime changes, tax avoidance, transfer pricing	
Best disclosure:		Vodafone (A)
Engagement List:	Based on potential investor impact of allegations	Ericsson (D)

Source: Company reports, Kepler Cheuvreux

Our findings show that there is much less variation in the final scores of the global operators compared to the extractives sector where there has been increased focus on reporting for a number of years.

The non-diversified national operators under our coverage are Mobistar, Belgacom, Elisa, Iliad, Jazztel, Telenet. Of these, only Mobistar and Telenet disclose concrete policies mentioning corruption specifically but the exposure is minimal compared to those listed below.

Country-by-country payments

The sector had been the subject of proposed EC Accounting Directive legislation, but was dropped from the final draft. In the long term it is therefore a possibility that it could be re-introduced into a country by country reporting legislative proposal. Underpaying for licences has been the key corruption issue for the sector – country-by-country reporting can be intrinsic in highlighting issues – or potential underpayments.

Telefonica demonstrates the greatest clarity by current disclosure practice where key countries of operation have revenues and payments highlighted. This kind of transparency, though still not at the levels proposed by EC regulation, is rare. ^{lii}

Table 45: Telecoms

	Scores				Anti-corruption disclosure criteria				
	Disclosure (A-F)	Geo Exposure (max = 6)	Allegations (A-D)	Risk exposure view (A-F)	Leadership	Risk	Policy	Training	Whistle blowing
Vodafone	A	5	A	B	A	A	A	A	A
KPN	B	3	A	B	D	B	B	D	A
France Telecom	B	5	A	C	A	B	B	B	C
Telecom Italia	C	4	A	C	B	C	B	D	A
TELE2	C	4	A	C	D	C	C	C	C
Deutsche Telekom	C	6	A	C	C	C	B	B	C
Telekom Austria	B	4	C	C	C	B	A	D	D
Millicom	B	6	A	D	D	B	B	D	A
Telenor	C	5	C	D	C	B	B	D	C
Telefonica	C	5	A	D	C	E	B	E	B
TeliaSonera	B	4	D	D	B	B	B	D	B
Ericsson	B	5	D	D	D	C	A	C	B

Source: Kepler Cheuvreux

Summary of major allegations

TeliaSonera

TeliaSonera has been the subject of significant concern amongst investors due to alleged activities in Eurasia – particularly Uzbekistan, resulting in the resignation of CEO Lars Nyberg ^{liii} after a Swedish TV ^{liv} documentary claimed payments in the region ended up directly in the pockets of the ruling President's family. Chairman Anders Narvinger stated *It's quite clear that the local partner should have been investigated more thoroughly.* In this sense, TeliaSonera has made clear improvements and scores a B in the relevant area of risk assessment. The investigation by the Swedish regulator continues and further impacts such as penalties and forfeitures cannot be ruled out. With little exposure to the US we would expect regulatory impact to be limited to Europe.

Countries of Risk include: Uzbekistan and Kazakstan

Telenor

Telenor has had a long running issue with its acquisition of 22 JV licenses in India with local partner Uninor ^{lv}. It states it wishes to stay in the country, but a strategy has not been finalised at the time of writing - following the withdrawal of the licenses amid allegations of underpayment by the Indian authorities. "Risk assessment" in the table above is a key indicator and the company scores a "B" based on publicly available information. For Telenor, this is a positive forward-looking indicator based on the origin of the corruption issues.

Countries of Risk include: Pakistan, India, Bulgaria

Deutsche Telekom

Hungarian Magyar Telecom and parent Deutsche Telekom AG, settled with US authorities in December 2011 with Magyar paying USD31.2m to the SEC and USD59.6m to the US Department of Justice with an additional USD4.36m paid by Deutsche Telekom and a two-year deferred prosecution agreement. Three former Magyar executives were said to have fabricated fake consulting and marketing contracts to pay USD6m to Macedonian officials and USD9m to Montenegro officials in attempting to block a new market entrant.

Countries of Risk include: Poland

Ericsson

Though Ericsson scores a B on anti-corruption polices it remains red flagged due to current allegations. In May, news articles announced that the SEC was investigating possible bribery in Romania over a contract valued at EUR40m. As the global regulator that has been the most aggressive, this as an indication that the maximum penalty for the company could therefore be more significant. The company also has strong links with 26.33% of total FY 2012 revenues there, alongside a Level II ADR listing.

Emerging markets, where most corruption risk occurs, continues to be a strong revenue driver for the company, also with China and NE Asia comprising 16.8% of revenue, Latin America 10.21%, Middle East 7.22%, South East Asia 7% and Sub Saharan Africa 5.27%. The company is very highly diversified geographically, with a presence in 180 countries.

US investigations have historically resulted in the highest penalties

As allegations have been presented in Bulgaria, Slovenia, China, Libya, Poland and Romania there is a risk of a prosecution for “systematic bribery” if evidence shows that indeed wrongdoing occurred in multiple territories (and we emphasize that at this stage that is still far from the case). Prior allegations have included that UBS found CHF 550m of accounting irregularities in a banking transaction in 2003. More recently, an Ericsson China employee was investigated in 2010 for allegedly accepting a USD5.68m bribe for a contract reportedly valued at USD285m – however, we emphasize that Ericsson was not held to have carried out any wrongdoing.

Countries of Risk include: Malaysia, China, South Africa, Brazil, Egypt

Telekom Austria

Telekom Austria has experienced a number of controversies in recent years:

Three former Telekom Austria managers received jail terms for share price manipulation where large cash payments were made in secret meetings. Allegations surrounding illicit payments from Telekom Austria to lobbyists date back to before 2006. Improper use of lobbying payments from a “slush fund” has been a key issue. An intermediary is said to have received EUR1.1m from Telekom Austria to build a police telecoms network in 2004^{lvi}.

In 2008 there were allegations from an anonymous whistle blower around the Euro 2008 Football Championship and potential kickbacks in relation to the rental of a key venue^{lvii}. According to a November 2012 press release from the company, group CEO Hannes Amestreiter is under investigation. The company denies all wrongdoing^{lviii}.

Chinese Telecom equipment manufacturer Huawei is accused of paying bribes in 2011 to Telekom Austria officials of EUR6m to secure a EUR60m contract. Cyprus-based bank accounts^{lix} were allegedly used after an intermediary facilitated the transactions.

Construction

Although the sector ranks very highly in the bribe payers index for the payment of bribes, there have been fewer visible cases against construction companies than other sectors such as defence, extractives and capital goods. Critically, the sector suffers significantly from the more routine and smaller exchanges of illicit payments.

Table 46: Risk profile for the construction sector

Risk level	High
Key factors	Emerging market subsidiaries, Political donations, emerging markets state infrastructure contracts, Integration of parent group ethics policies into global subsidiaries, daily operational exposure to smaller illicit payments – particularly facilitation payments
Best disclosure	Balfour Beatty (A)

Engagement List:	For both disclosure and allegations : Boskalis (E) Impreglio (E)
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Source: Kepler Cheuvreux

According to a survey by non-profit organisation TRACE, the engineering/construction sector accounted for 10.5% of global cases between 1977 and 2011.^{lx}

At a sector level, a key danger is the use not just of illicit payments at the procurement level, but also at a daily operational level, as the sector is the most intensively dependent on permits, goods recovery, transportation and licences. The risk from any systematic use and particularly authorisation of facilitation payments is therefore potentially elevated for the sector.

Table 47: Construction

	Scores				Anti-Corruption Disclosure Criteria				
	Disclosure band (A-F)	Geographical exposure (max = 6)	Allegations (A-D)	Risk exposure view (A-F)	Leadership	Risk	Policy	Training	Whistle blowing
Balfour Beatty	A	3	A	A	A	B	A	B	A
Skanska	B	3	A	B	A	B	A	C	B
Hochtief	B	3	A	B	A	E	B	C	B
Vinci	C	3	A	C	D	B	B	E	D
Ferrovial	C	2	C	C	E	C	D	C	A
ACS	C	4	A	C	B	B	C	C	B
Fraport	C	3	A	C	D	C	B	D	B
Bilfinger	C	3	C	C	C	C	B	C	B
Sacyr Vallehermoso SA	C	3	B	C	B	E	B	C	C
Eiffage	C	2	A	C	E	C	B	E	D
Bouygues	C	3	B	C	B	C	A	C	D
FCC	C	3	B	D	F	C	B	C	C
Abertis	D	3	A	D	D	E	C	E	D
CAF	D	4	A	D	D	C	B	C	F
OHL	C	6	B	E	C	E	B	D	C
Astaldi	C	6	B	E	C	C	B	C	D
Impregilo	D	6	C	E	D	C	B	E	D
Boskalis	E	4	C	E	C	C	E	F	E

Source: Kepler Cheuvreux

We note the recent allegations against Spanish PM Rajoy of personal involvement in bribery involving Spanish construction firms during the years of the property boom there. After a story originating in El País, the global press have mentioned FCC, OHL and Sacyr Vallerhermoso as contributing funds to the Spanish ruling party.^{lxii} At the time of writing, the Swiss authorities had opened a criminal investigation into money laundering regarding accounts used there in alleged relation to these payments.^{lxiii}

Though no prosecutions, Spain remains a flashpoint

Table 48: Spanish construction political corruption allegations

Company	Board Member	Position	Alleged donation (EUR)
OHL	Jose Miguel Villar Mir	Chairman	530 000
Sacyr Vallehermoso	Luis del Rivero	Former Chairman	380 000
FCC Construcción, S.A.	José Mayor Oreja	CEO	165 000

Source: El País^{lxiii}

Countries of Risk include:

OHL: Spain, Brazil, Mexico

Sacyr Vallerhermoso SA: Spain, Panama, Angola, Italy, Costa Rica

FCC: Spain, China, Mexico, Romania, Brazil, Peru, Columbia, Poland

Ferrovial encountered allegations of paying bribes to Catalan officials in Spain in 2010, worth 4% of the contract value according to the El Pais newspaper^{lxiv}. EUR5.9m was allegedly received via donations to a Barcelona concert hall, which were then routed to political officials.

Countries of Risk include: Poland & Spain, not present in emerging markets traditionally associated with higher corruption risk as per Transparency International CPI.

Outside Europe, SNC-Lavalin Group has been subject to a series of major corruption allegations, but like the Spanish companies above, recent reputational and legal fallout has been domestic with allegations of corruption in its home country of Canada (as well as a variety of foreign territories). We mention this example as evidence that for the construction sector a large amount of residual risk may remain in home countries of operation and therefore developed markets – where both connections to government and large contract values present an intrinsic element of risk of illicit payments.

Canada's SNC-Lavalin also shows how domestic corruption is in focus

Boskalis

We would highlight Boskalis as a company subject to a number of higher-risk regions and a number of allegations. In this context, our view is that enhanced communication on anti-corruption systems would be reassuring for investors.

The South African subsidiary of Boskalis was charged with corruption in March 2012 by the country's Department of Agriculture, Forestry and Fisheries. Subsidiary SMIT Amandla Marine was acquired by Boskalis in 2010. A competitor Sekunjalo maintains that it won a contract, but SMIT continued to work with the DAFF for a further 6-9 months through a contract extension obtained by illicit means. The contract had already allegedly existed for seven years since 2005 without an open tender process. Boskalis and subsidiaries have also

faced allegations in Argentina and Uruguay^{lxv} (investigation of a renewal of dredging contract with subsidiary RioVia), , and Mauritius in recent years^{lxvi}.

Countries of Risk include: South Africa, Surinam, Nigeria, Namibia, Oman, Brazil, Argentina

SBM Offshore

SBM Offshore NV has faced controversies after sales practices by third parties were found to be “improper”. To its credit, the issue was found through an internal investigation and created a new board-level position for governance and compliance. However, in April the company issued further information that criminal charges may be a possibility in the Netherlands and US regarding illicit payments to officials in Africa stating “The investigation is expected to be completed in 2013”^{lxvii}

Countries of Risk include: Equatorial Guinea, Angola, Malaysia, Nigeria, Brazil

Balfour Beatty

Balfour Beatty reached a settlement with the UK regulator the Serious Fraud Office (SFO) in October 2008 related to allegations concerning a major Alexandria Library project in Egypt dating back to 2001. The penalty amount was GBP2.25m and the SFO considered that the firm had been “let off lightly” due to its co-operation. The actual charges related to false accounting surrounding potentially illegitimate payments. Since then, the company has adopted best practice procedures in implementing relevant anti-corruption systems.

Countries of Risk include: India, Brazil, South Africa

Bilfinger

In November 2012, Bilfinger’s offices in Mannheim Germany, Austria, Hungary and Slovakia were raided in connection to bribery allegations over a EUR495m motorway project in Hungary^{lxviii}. Illicit payments have been said to be worth EUR5-6m, two employees related to the allegations were “relieved of their duties” with a further employee retiring and a fourth individual involved who was not a Bilfinger employee.^{lxix}

Julius Berger, the Nigerian subsidiary of Bilfinger, were repoted to have faced allegations^{lxx} of bribery to the Nigerian government in a probe by German authorities in 2008.

Countries of Risk include: India (including acquisition), eastern European exposure. Nigeria reduced but Asia and Middle East growth targeted

Skanska

Skanska faced allegations^{lxxi} in 2007 in Argentina regarding a group of seven employees who were dismissed for tax avoidance and bribe payments to secure a gas pipeline contract. Skanska management in Stockholm were also allegedly accused but the allegations were denied.

Countries of Risk include: Poland, Czech Republic, Argentina, Brazil, Colombia, Peru, Venezuela

Impreglio

Impreglio encountered a penalty of USD2m from a Lesotho court related to illicit payment via intermediaries for a Lesotho dam project in 2006.

Argentinian authorities began an investigation into Impreglio and another firm in 2008 in relation to alleged bribes of USD800m paid to an Argentinian surveyor to change a report in relation to a Paraguay dam project^{lxxii}.

The former CEO Ponzelleni was also under investigation^{lxxiii} for allegations of high-level corruption and was arrested by the Italian authorities in 2012.

Countries of Risk include: Algeria, Columbia, Kuwait, Libya, Nigeria, Panama, Romania, Russia, South Korea, Venezuela

Astaldi

Astaldi was faced with allegations^{lxxiv} of corruption in relation to public transport projects in Algeria in 2012. It had also faced allegations in Bolivia for a motorway contract in 2003^{lxxv}. Neither of the above allegations has resulted in fines to date.

Countries of Risk include: Romania, Poland, Peru, Russia

Bouygues

Bouygues encountered French press (including Le Monde) allegations of corruption in relation to a Ministry of Defense building contract in December 2011, but no charges have been brought against the company.^{lxxvi} Less mainstream sources have made allegations in relation to Turkmenistan^{lxxvii}.

Capital Goods

Table 49: Risk Profile for Capital Goods

Capital Goods	
Risk level	Very High
Key factors	High-value government contracts, use of intermediaries,, regulated verifications and licencing, emerging markets exposure, export controls, facilitation payments
Best disclosure	Siemens (A), ABB (A)
Engagement List:	For allegations : Alstom For lack of disclosure: Kone OYJ (E)

Source: Kepler Cheuvreux

Capital Goods remain a highly exposed sector even without any proposed requirements for country by country reporting. With exposure to large state contracts and a variety of licensing, customs and export requirements within both the supply chain and sales processes global players in this sector will continue to face significant challenges.

Table 50: Capital Goods

Company	Scores				Anti-corruption disclosure criteria				
	Disclosure score grade (A-F)	Geo exposure (6=max)	Allegations (A-D)	Risk Exposure Grades (A-F)	Leadership	Risk assessment	Policy	Training	Whistle blowing
ABB	A	5	A	B	A	A	A	A	A
Siemens	A	5	B	B	A	A	A	A	A
Assa Abloy	B	3	A	B	B	B	A	B	D
Weir Group	B	4	A	B	F	C	A	B	A
Man Se	B	4	B	C	A	A	B	C	B
Alcatel Lucent	B	4	B	C	A	B	A	C	B
Rexel	D	2	A	C	C	E	B	D	E
Atlas Copco	B	4	A	C	D	D	A	C	A
Orkla	C	3	A	C	C	F	A	D	C
Smiths Group	C	3	A	C	B	F	B	B	D
Sandvik	B	5	A	C	A	B	B	C	C
Koninklijke Philips	B	5	A	C	D	C	A	B	C
Schneider	C	4	A	C	C	E	A	D	D
Legrand	C	4	A	D	C	D	A	E	D
Nexans	D	4	A	D	C	F	B	A	F
Alstom	B	5	D	D	B	C	A	C	D
Alfa Laval	D	5	A	D	D	E	C	C	E
Prysmian	D	4	A	E	F	E	B	E	E
Ansaldo	D	5	B	E	D	F	B	D	D
Kone Corp	E	4	A	E	F	D	D	B	F

Source: Kepler Cheuvreux

Siemens

The penalty against **Siemens** remains the largest ever, both in its US element of USD800m and globally rising to USD2bn. As an indicator of the typical longevity of major corruption cases we note that even in 2013 (for Argentina bribery allegations commencing in 1996) the US regulator was still pursuing a former Siemens executive - the ex CEO of Siemens Argentina - for his role in the illicit payments. Though the case was dismissed due to

jurisdictional issues it received mainstream financial press coverage^{lxxviii}. A further seven former Siemens managers were also being pursued. Another former board member reached a personal settlement with the SEC for his part in the allegations for USD275,000 in April 2013.

We also note that a former compliance officer of the company launched a lawsuit against Siemens in China in January 2013, after it accused the company of unfairly dismissing him after he attempted to expose a bribery scheme related to medical equipment sales to Chinese and North Korean hospitals. The informant brought the issues under the Dodd Frank incentive scheme for whistle blowers which offers significant financial rewards. No further information is currently available as to the credibility of the claims.

China was also the location for further claims of bribery against Siemens in 2011, after an executive at China Mobile was allegedly sentenced to a death penalty for accepting bribes from Siemens managers.

We summarise some of the many issues prior to 2013 below:

Allegations surfaced in Kuwait in June 2011 after employee whistle-blowing over an energy and water ministry project worth EUR1.25m. The positive sign was that the incident was internally detected. Siemens maintained that it was looking at bringing charges against the former managers involved^{lxxix}.

There were allegations by the Greek government of payments made to public officials, politicians and former management of Hellenic Telecommunications between 1997 and 2002 to win contracts for the 2004 Olympic Games after making alleged bribery payments. In March 2012, a settlement was reached with the Greek government, which accepted EUR170m^{lxxx}. The deal also included a EUR100m investment by Siemens in its Greek subsidiary and reopened access for Siemens to the country's public procurement system.

In May 2010, Siemens lost the right to bid for World Bank-funded projects in four African countries (Nigeria, Egypt, Cameroon and Liberia), following accusations of bribing officials to secure telecom supply contracts.

In April 2009, in Bangladesh, Siemens was cited^{lxxxi} as having paid USD180,000 in bribes to win a USD40m contract with the Bangladeshi government.

After Siemens was found guilty by a Munich court of charges of bribery in October 2006 in relation to paying bribes in Nigeria, an investigation was launched by local authorities between 2002 and 2005. EUR10m of bribes had been paid to local officials between 2001 and 2004. However, after out of court settlements in the "mid double digit euro million range", the debarment and charges were dropped according to official Siemens legal announcements^{lxxxii}.

Countries of risk include Iraq, Brazil, China

Alstom

In April 2013 three Alstom executives were charged with involvement with illicit payments in Indonesia for a power project with the use of consultants. The first was a VP for global sales in Alstom USA and the other two also former VPs of sales for the US unit of Alstom^{lxxxiii}.

In November 2011, **Alstom Network Schweiz AG** agreed to pay CHF36.4m in compensation and a CHF2.5m fine to the Swiss authorities in bribery-related charges concerning payments to government officials in Latvia, Tunisia and Malaysia by its "commercial agents". The Swiss Attorney General found no evidence to support allegations of any co-ordinated bribery systems within the company such as the "slush funds" which had been used by Siemens.

Three UK board members were arrested in England in March 2010 (but later released) in relation to alleged payments amounting to GBP81m between 2004 and 2010. Of the three board members, two remain in their positions and the third is deceased.

Significantly, in Norway, at the end of 2011, the influential Norwegian Government Pension Fund Global put Alstom on a four-year observation period regarding potential corruption risks in its businesses. A report issued by the Norwegian Council of Ethics in December 2010 recommended the exclusion of the company from the fund highlighting that "the management of Alstom does not take the problem (of corruption) seriously enough" as "management considers that the company is the victim, and thus transfers the responsibility for the misconduct onto individual employees."^{xxxiv}

Countries of risk include Russia, India, Brazil, Kazakhstan, Saudi Arabia, China, Thailand

The Weir Group

The Weir Group was fined GBP3m (reduced from GBP 4.5m due to co operation and reform) for UN Oil for Food bribery allegations in 2010, and had agreed to repay GBP13.9m in profits gained from a reported GBP1.5m payment to an Iraqi agent to influence the government. Since this settlement there have not been further credible allegations and a number of anti-corruption systems have been implemented with the company scoring a « B » for public disclosure and remaining at a « B » grade for overall risk exposure.

Countries of risk include India, China, Brazil, DRC

Alcatel-Lucent

In December 2010, **Alcatel-Lucent** agreed to pay USD137m to US authorities in order to finalise bribery settlements. The group was suspected of illicit payments in 2000 and the following years in Costa Rica, Honduras, Taiwan and Malaysia in order to win contracts.

USD45m is due to the SEC and USD92 to the US Department of Justice. If the group fully complies with the terms of the Deferred Prosecution Agreement (DPA), the Department of Justice will dismiss the charges by 2013.

Three subsidiaries – Alcatel-Lucent Trade International AG, Alcatel Centroamerica and Alcatel-Lucent France – were involved, and the settlement includes a French compliance monitor for a three-year period.

In Malaysia, Alcatel-Lucent was debarred for one year to early 2012.

In Costa Rica, Alcatel-Lucent France paid USD10m in damages to the Costa Rican State for its part in USD2.5m in payments related to presidential election funding in 1998-2002, and a local competitor "ICE" filed USD400m suit in the US for compensation for its loss from

Alcatel-Lucent's corruption in May 2011. The former Costa Rican president was sentenced to prison in relation to the receipt of bribes from Alcatel in April 2011^{lxxxv}

The company has declared ongoing investigations in France and Malaysia.

Countries of risk include India, Malaysia, Indonesia, China, Argentina, Iraq

Ansaldo

Ansaldo, which is 40% held by Finmeccanica had allegations^{lxxxvi} in 2011 that it had paid bribes to ENI and Saipem for contracts.

Countries of risk include Saudi Arabia, Morocco

Philips

Philips settled bribery allegations^{lxxxvii} related to Poland for USD 4.5m in April 2013 in relation to medical equipment sales. A case against former employees of Philips and hospital staff appears to be ongoing.

Countries of risk include India, China, Russia

ABB

ABB reached a settlement with US authorities in September 2010, paying a total of USD58.3m in disgorgement prejudgment interest and fines. The charges were related to an electric utility in Mexico and the UN Oil-for Food programme in Iraq.^{lxxxviii}

The allegations in the Mexican case were that USD2.7m in payments had been made to obtain over USD100m in total according to SEC documents.

The Iraqi case relates to subsidiaries alleged to have paid USD300,000 in bribes to the Iraqi government. Revenues generated were USD13.5m and profits USD3.8m.

Of note is that in 2012 an ongoing case in the US against a former ABB employee was dismissed in a Texas court due to lack of evidence linking the individual to illegal conduct.

There had also been an investigation into conduct by ABB Italy employees dating to before 2009 but no further information was found regarding this allegation.

Countries of risk include Brazil, China, India, South Korea

MAN SE

MAN SE was reportedly^{lxxxix} nearing settlement with ex Chief Executive in relation to a 2009 bribery investigation in August last year. Its December 2009 penalties reached EUR 150.6 m in relation to allegations^{xc} that over 100 suspects gave bribes to secure sales of commercial vehicles. Several executives had resigned prior to the settlement.

Countries of risk include China, India, South Korea

Aerospace & Defense

We examined the sector in detail in our prior report published in January in this series in conjunction with the Transparency International defence team. This section builds on that report to score the companies using the methodology we highlight. The initial transparency scores are taken directly from the results of the Transparency International Defense Companies Index.

Table 51: Risk profile for aerospace & defence

Aerospace & Defence	
Risk level	Very High
Key factors	High-value government contracts, offsets, political protection, use of intermediaries, offsets, M&A due diligence, emerging markets exposure, export controls,
Best disclosure (based on public scores in line with other sectors)	BAE Systems (B), Thales (B)
Engagement List:	For allegations : EADS, Finmeccanica, ThyssenKrupp AG, Rolls Royce For lack of disclosure: Zodiac Aerospace (F)
Source: Kepler Cheuvreux	

Table 52: Aerospace & Defense

Company	Scores				Anti-Corruption Disclosure Criteria				
	Disclosure score grade (A-F)	Geo exposure (6=max)	Allegations (A-D)	Risk Exposure Grades (A-F)	Leadership	Risk assessment	Policy	Training	Personnel
BAE Systems	B	4	A	B	B	B	B	B	A
Meggitt	B	3	A	B	A	C	B	B	B
Thales S.A.	B	3	A	B	A	B	B	C	C
Finmeccanica S.P.A.	C	4	D	D	D	C	B	C	B
MTU Aero Engines	D	3	A	D	D	E	B	E	C
Safran S.A.	D	4	B	D	D	C	C	C	F
ThyssenKrupp Ag	C	3	D	D	A	D	E	A	B
Saab Ab	C	4	D	D	C	C	C	F	B
Rolls Royce	C	5	A	E	C	C	C	D	A
Tognum	D	4	A	E	C	F	D	F	C
Dassault Aviation	E	4	D	E	D	F	E	E	F
EADS	C	6	B	F	C	D	B	E	D
Rheinmetall Ag	E	4	A	F	D	F	E	F	F
Zodiac Sa Holding	F	4	A	F	F	F	F	F	F

Source: Kepler Cheuvreux, Transparency International

Prior settlements led to improved performance: the table shows **BAE Systems** as managing its risk, following its major settlements, with a number of good indicators that anti-corruption systems have been implemented and integrated into the culture of the company via leadership, risk assessment, training and whistle blowing systems. The same applies to **Thales**, though in certain areas of disclosure such as “leadership”, the company scores less well.

BAE & Thales have shown clear reforms in their company culture since settlements

Finmeccanica, Rolls Royce, EADS and ThyssenKrupp (though only partly involved in the aerospace and defense sector) remain the most exposed, and we note the key allegations below.

US government: Who is exposed?

We note the actions of the Environmental Protection Agency (EPA) in the US that temporarily suspended new contracts with BP following the settlements reached. The additional impact for companies from such “debarment” is not negligible in the defence sector and we note exposure to US state contracts below, according to Bloomberg data. Of note also is a number of non aerospace and defense companies (for example fuel and medical supplies providers) who also have varying degrees of exposure.

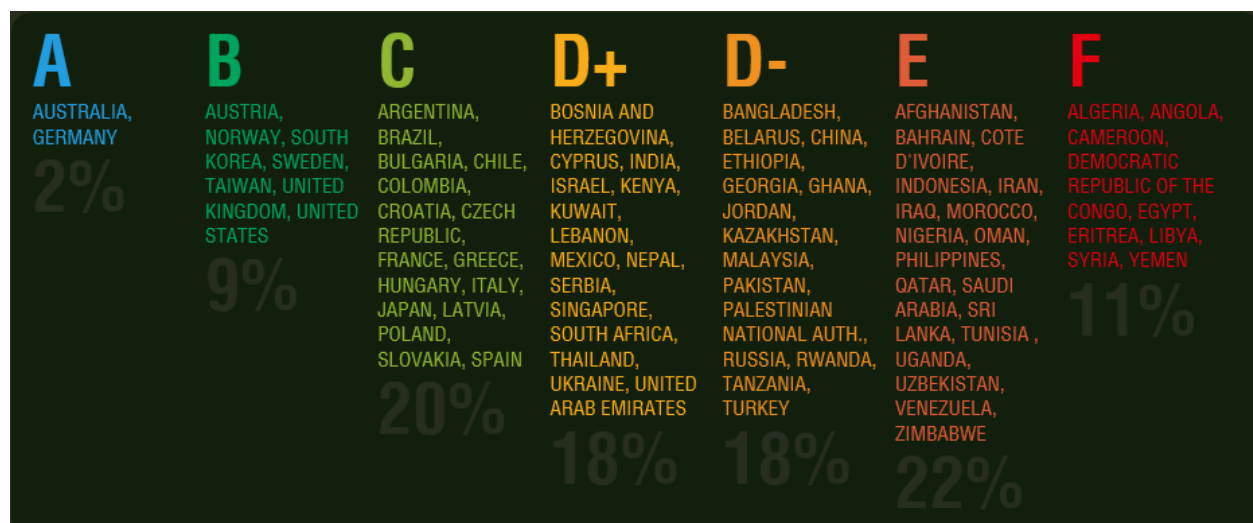
Table 53: US defence contracts

Company	Country	Contracts USDbn	% of revenue	Top Customer	Top Category
Chemring Group PLC	Britain	0.34	29	Army	Technology equipment
BAE Systems PLC	Britain	6.34	24	Navy	Equipment-related services
QinetiQ Group PLC	Britain	0.54	23	NASA	Knowledge-based services
Vesuvius PLC	Britain	0.32	13	Treasury	Materials
Serco Group PLC	Britain	0.66	8	Navy	Knowledge-based services
Finmeccanica SpA	Italy	1.27	6	Army	Technology services
Rolls-Royce Holdings PLC	Britain	0.9	5	Navy	Engines and aircraft components
G4S PLC	Britain	0.57	5	Energy	Facility-related services
AP Moeller - Maersk A/S	Denmark	1.35	2	U.S. Transportation Command	Transportation services
Sanofi	France	0.89	2	Health and Human Services	Medical supplies
Royal Dutch Shell PLC	Netherlands	2.89	1	Defense Logistics Agency	Fuel
BP PLC	Britain	2.51	1	Defense Logistics Agency	Fuel
European Aeronautic Defence and Space Co NV	France	0.65	1	Army	Engines and aircraft components
GlaxoSmithKline PLC	Britain	0.54	1	Health and Human Services	Medical supplies
ACS Actividades de Construcción y Servicios SA	Spain	0.41	1	Army	Construction services
Siemens AG	Germany	0.42	0	Veterans Affairs	Medical supplies
Total SA	France	0.39	0	Defense Logistics Agency	Fuel

Source: Bloomberg

We note also the work of the Transparency International Defense Team in surveying government defence departments on their ability to manage and reduce corruption risks. Australia and Germany are the only countries to score an A, with the UK and the US at grade B and France at grade C.

Chart 2: Transparency International defence sector: government index scores



Source: Transparency International Defense Team Government Index

Summary of allegations

SAAB

SAAB announced in May 2011 that a South African transaction in relation to a subsidiary sale of fighter jets was being investigated. The allegations^{xci} relate to the company Sanip (in which BAE systems was also an owner) and potential payments of USD 7.9m between 2003 and 2005. However, the prior investigations of BAE Systems conduct did not lead to specific prosecutions and the company divested its stake in SAAB in 2011. An internal audit from SAAB found that ZAR24m was paid from BAE Systems to Sanip and to a consultant thereafter^{xcii}. The Transparency International Survey also allows for companies to submit information confidentially that was not made public, on this basis SAAB improves its disclosure score to a "B" grade – which is a good forward looking indicator.

Countries of risk include India, Brazil

Finmeccanica

Finmeccanica company chairman Pier Francesco Guarguaglini resigned in November 2011 during a major corruption investigation.

Guarguaglini was accused by the Italian media of making illicit payments to politicians.

There were allegations of systematic bribery of the Civil Aviation Authority by the company's Selex unit^{xciii}, the management of which included Guarguaglini's wife. We note that Guarguaglini denies the allegations.

Bloomberg and other news agencies^{xciv} reported that at end-February 2012 the Indian authorities began investigations into bribery over a contract for twelve Agusta Westland helicopters valued at EUR560m. The company denied all allegations in a press release.

The company states that India is "a priority market" and that it has an expected order intake from this country of EUR500m over 2011-15.

To lose one CEO is unfortunate, to lose two...

In 2012, originating in the Italian press, some reports of bribery allegations emerged in Canada, regarding AW-139 helicopters sold to specialised transport company Ornge^{xcv}. A manager was arrested in October 2012 and held for questioning on bribery allegations in Panama and Brazil, according to the financial press including Reuters and the Wall Street Journal^{vii}. Finmeccanica CEO Giuseppe Orsi was placed under house arrest in February 2013 and there were reports that India was considering further action against the AgustaWestland unit at the centre of the bribe allegations. With the current CEO, Alessandro Pansa, we would like to see a clear leadership commitment to anti-bribery responsibilities and continue the anti-corruption structures that have begun to be implemented.

Countries of risk include India, Brazil

EADS

According to press reports, a financial controller alerted superiors in 2007 about lavish gifts being presented in the procurement process for new contracts in GPT Special Project Management, an EADS subsidiary working exclusively for the UK Ministry of Defence. A programme director later discovered a potentially similar pattern. Both attempted to report their suspicions to internal management, but they were allegedly rebuffed, according to a Financial Times article, which stated that the company was *"still approving contracts up to late 2010"* despite GBP11.5m in *"unexplained payments from 2007 to 2009"* in relation to *"bought-in services"*^{xcvi}.

As there is an official SFO investigation and there have been reported raids in other countries, there is a possibility of further enforcement action. The company has hired an external agency, Ethic Intelligence, to conduct an audit into compliance systems after admitting it had reacted too slowly to whistleblower reports.

"The group acknowledges not to have reacted swiftly enough when the allegations were first brought forward internally at a subsidiary level. EADS has committed to improving processes that will speed up responsiveness when concerns are raised."^{xcvii}

The New York Times and other press reported in June 2011 that the UK Serious Fraud Office was investigating allegations of bribery of Saudi officials to win a USD3.3bn contract. It was also alleged in May 2011 that the firm presented gifts of excessive value, such as cars and jewellery, as well as cash, to obtain a GBP2bn communications contract.^{xcviii}

In November 2012, EADS started to receive media coverage^{xcix} on alleged bribes in Austria (EUR 50m), after its German offices (in Munich) were searched, reportedly in relation to the sale of Eurofighter planes worth USD2bn. Furthermore, Swiss authorities were reported to have searched properties in Switzerland in relation to this probe. The allegations in the latter country relate to the use of front companies in money laundering operations. The company CEO Tom Enders had stated soon afterwards *"I take these allegations very seriously and EADS is fully cooperating with the public prosecutors on this matter. However, before having the full picture of what seems to be a very complex matter, we should not rush into conclusions and communication. The company will update the public on further developments as appropriate."*^c

Countries of risk include Saudi Arabia and India

Rolls Royce

Allegations regarding illicit payments in China, Indonesia and other territories surfaced in December 2012. The allegations date back to before the introduction of the UK Bribery Act, which places a higher bar on corporate standards regarding anti-corruption.

Of particular note is the allegation that USD20m was paid to the son of the late former President Suharto, together with the gift of a Rolls Royce in order to secure aerospace contracts with Garuda, the Indonesian airline.^{ci}

Engines purchased by Air China (2005) and China Eastern Airlines (2010) have also had allegations related to potentially illicit payments by Rolls Royce.^{cii}

Also of note for investors is that the allegations^{ciii} originate from an internal whistleblower, who claimed that the company was not responsive to his findings and that his career progression was put at risk. In this context, we highlight the critical role of company whistleblowing policies – which should ideally be external, anonymous, audited and open to all stakeholders for matters related to corruption, in addition to a publicly declared non retaliation policy.

In May 2013, the Head of Rolls Royce Aerospace division resigned, and the press contained multiple allusions to the current bribery allegations^{civ}

Countries of risk include Saudi Arabia, China and Indonesia

Rheinmetall

Rheinmetall was banned in India for ten years in 2012. In the same year, after the ban, an Indian businessmen was arrested and charged with attempting to make illicit payments to civil servants to prevent the blacklisting of Rheinmetall Air Defense. The original source of information was whistle-blowing to authorities. The company rejected the allegations according to press reports^{cv}.

Countries of risk include China, Indonesia, South Korea and Russia

ThyssenKrupp

ThyssenKrupp scores a C for disclosure but is a company that volunteered internal information which pushed the score up to an “A” grade. As a forward-looking signal, this is promising. However, the company is still dealing with bribery allegations against a backdrop of some governance turbulence (eg, the resignation of supervisory board chief Gerhard Cromme earlier this year).

In April 2013, the company offered an “amnesty” for whistle blowers – stating that no unilateral terminations would occur for truthful and complete allegations presented. The action is likely to strengthen the credibility of the whistle blowing system with staff, but also potentially signals that previous employee “buy ins” may have been lacking. This fits with an earlier statement the company had made “*ThyssenKrupp is in the middle of a major change process*”.

Whistle-blowing is an opportunity to manage corruption risks

Claasen, an executive board member with a portfolio of responsibilities including legal & compliance and Communications, requested to be suspended^{cvi} from his position in December 2012 due to a corruption investigation related to lavish hospitality for journalists.

In November 2012, Reuters^{cvi} reported on alleged fraud in bribery in eastern Europe for projects based in Kazakhstan, Uzbekistan, Azerbaijan and China.

2011 allegations originating in the German press suggested improper payments as part of the JV called Marine Force International with Ferostall. A Thyssen internal investigation found no evidence of wrongdoing.

Countries of risk include China, Kazakhstan, Uzbekistan, and Azerbaijan

Safran

Safran received a penalty in its home country of France in 2012 of 500,000 EUR in relation to a Nigerian contract for identity cards dating back to 2000-2003. Two executives on trial were not prosecuted. The company had made a statement that it would appeal the decision.

Countries of risk include: India, Qatar, Brazil

Tognum

The Wall Street Journal^{cvi} carried an article in October 2011 that German authorities had launched an investigation into Tognum including an allegation against a member of the board. An auditor report by Ernst & Young was said to have been provided with details of a potential breach in relation to 2000- 2011 South Korean defense related sales and USD37m in commissions related to subsidiary MTU Asia. The company's response was positive in that it launched an independent review, re iterating zero tolerance as a priority and relieving supervisory board member Peter Kneip of his position. The company is jointly owned by Rolls Royce and Daimler. With internal data provided to Transparency International the company achieved a grade "C" for overall disclosure.

Countries of risk include: China, India, Indonesia

Table 54: Engagement questions

Area	Engagement question	Reason	Regulatory exposure	Best practice example	Best practice company
Governance	How is the board made responsible for anti-corruption measures?	"Tone from the Top"	Anti Corruption Laws - US FCPA, UK Bribery Act + other national regulations	Reporting line direct to CEO, Ethics Committee consisting of Board members	Technip, Siemens
	Is the company and key (especially listed) subsidiaries willing to make a signed & publicly available CEO statement to endorse Code of Ethics ?	"Tone from the Top" and indicates CEO responsibility	Anti Corruption Laws - US FCPA, UK Bribery Act + other national regulations	CEO states commitment clearly	Anglo American
Whistle blowing	Is the company willing to disclose statistics on a) the number of reports coming through their whistle-blowing systems and b) the number of disciplinary actions as a result of violations of Code of Ethics both by employees and third parties such as contractors/ agents?	Indicates that the system is functional and the company capitalizes information to avoid informants reporting to external authorities	Anti Corruption Laws - US FCPA, UK Bribery Act + other national regulations. Whistle Blower Protection & Reward Laws US SOX, False Claims Act & Dodd Frank	Disclosure of number of cases , Breakdown of subject area ie Safety/ Fraud Number of Disciplinary Measures	BG Group
Facilitation payments	Is there a policy to ban facilitation payments (which are specifically outlawed in several countries)? If yes, then why does it not make it public?	UK Bribery Act legislates against these payments. If made in aggregate and in large volumes risk is higher. Difficulty of accounting for such payments even where they are legal in certain territories due to exposure to different legal jurisdictions	Anti Corruption Laws - mainly UK Bribery Act but potentially other national regulations also	Complete ban Operations strategy to reduce exposure to demands, engagement with senior officials, alliances with other firms, support from internal legal	Rio Tinto
Risk assessments	How is corruption risk included as a parameter in making business decisions?	Integrated consideration at a strategic level embeds corruption risk reduction more effectively and works preventative rather than reactive measure	Anti Corruption Laws - US FCPA, UK Bribery Act + other national regulations	Embedded in Country, Transaction, Business Opportunity & Partner Risk analysis	Statoil
Country by country & project reporting	Will the company disclose country level payments but also revenues and other key data?	Transparency can signal better risk management	Extractives: Dodd Frank 1504; EC Accounting Directive (If illicit payments are made, the likelihood of them being discovered may continue to increase in the mid term as a result of this regulation)	Country Level Payments and Project by Project Reporting	Statoil (country reporting) Rio Tinto (project reporting)
Company structure	Does parent company disclose fully the organisational structure of the company - especially foreign operations?	Transparency can signal better risk management	Tax & Anti Corruption Laws : Increased scrutiny of use of opaque global corporate structures	All material subsidiaries disclosed with country of incorporation and % ownership	Allianz

Source: Kepler Cheuvreux

Table 55: Appendix – list of higher risk countries defined from from CPI index

Country	CPI 2012 Score	Country	CPI 2012 Score	Country	CPI 2012 Score	Country	CPI 2012 Score
Poland	58	Burkina Faso	38	Mauritania	31	Burundi	19
Malta	57	El Salvador	38	Mozambique	31	Chad	19
Mauritius	57	Jamaica	38	Sierra Leone	31	Haiti	19
Korea (South)	56	Panama	38	Vietnam	31	Venezuela	19
Brunei	55	Peru	38	Lebanon	30	Iraq	18
Hungary	55	Malawi	37	Togo	30	Turkmenistan	17
Costa Rica	54	Morocco	37	Côte d'Ivoire	29	Uzbekistan	17
Lithuania	54	Suriname	37	Nicaragua	29	Myanmar	15
Rwanda	53	Swaziland	37	Uganda	29	Sudan	13
Georgia	52	Thailand	37	Comoros	28	Afghanistan	8
Seychelles	52	Zambia	37	Guyana	28	Korea (North)	8
Bahrain	51	Benin	36	Honduras	28	Somalia	8
Czech Republic	49	Colombia	36	Iran	28		
Latvia	49	Djibouti	36	Kazakhstan	28		
Malaysia	49	Greece	36	Russia	28		
Turkey	49	India	36	Azerbaijan	27		
Cuba	48	Moldova	36	Kenya	27		
Jordan	48	Mongolia	36	Nepal	27		
Namibia	48	Senegal	36	Nigeria	27		
Oman	47	Argentina	35	Pakistan	27		
Croatia	46	Gabon	35	Bangladesh	26		
Slovakia	46	Tanzania	35	Cameroon	26		
Ghana	45	Algeria	34	Central African Republic	26		
Lesotho	45	Armenia	34	Congo Republic	26		
Kuwait	44	Bolivia	34	Syria	26		
Romania	44	Gambia	34	Ukraine	26		
Saudi Arabia	44	Kosovo	34	Eritrea	25		
Brazil	43	Mali	34	Guinea-Bissau	25		
Macedonia	43	Mexico	34	Papua New Guinea	25		
South Africa	43	Philippines	34	Paraguay	25		
Bosnia and Herzegovina	42	Albania	33	Guinea	24		
Italy	42	Ethiopia	33	Kyrgyzstan	24		
Sao Tome and Principe	42	Guatemala	33	Yemen	23		
Bulgaria	41	Niger	33	Angola	22		
Liberia	41	Timor-Leste	33	Cambodia	22		
Montenegro	41	Dominican Republic	32	Tajikistan	22		
Tunisia	41	Ecuador	32	Democratic Republic of the Congo	21		
Sri Lanka	40	Egypt	32	Laos	21		
China	39	Indonesia	32	Libya	21		
Serbia	39	Madagascar	32	Equatorial Guinea	20		
Trinidad and Tobago	39	Belarus	31	Zimbabwe	20		

(lower score = higher perception of corruption)

Source: Transparency International

Table 56: Resource governance index from revenue watch

Rank	Country	Resource measured	Composite	Institutional and legal setting	Reporting practices	Safeguards and quality controls	Enabling environment
1	Norway	Hydrocarbons	98	100	97	98	98
2	United States (Gulf of Mexico)	Hydrocarbons	92	88	97	89	90
3	United Kingdom	Hydrocarbons	88	79	91	83	93
4	Australia (Western Australia)	Minerals	85	88	87	65	96
5	Brazil	Hydrocarbons	80	81	78	96	66
6	Mexico	Hydrocarbons	77	84	82	81	53
7	Canada (Alberta)	Hydrocarbons	76	67	72	74	96
8	Chile	Minerals	75	77	74	65	87
9	Colombia	Hydrocarbons	74	75	73	91	58
10	Trinidad and Tobago	Hydrocarbons	74	64	83	86	52
11	Peru	Minerals	73	88	83	56	55
12	India	Hydrocarbons	70	60	72	83	61
13	Timor-Leste	Hydrocarbons	68	77	82	70	28
14	Indonesia	Hydrocarbons	66	76	66	75	46
15	Ghana	Minerals	63	79	51	73	59
16	Liberia	Minerals	62	83	62	71	31
17	Zambia	Minerals	61	71	62	72	37
18	Ecuador	Hydrocarbons	58	70	64	65	28
19	Kazakhstan	Hydrocarbons	57	62	58	76	32
20	Venezuela	Hydrocarbons	56	57	69	67	18
21	South Africa	Minerals	56	69	31	75	72
22	Russia	Hydrocarbons	56	57	60	62	39
23	Philippines	Minerals	54	63	54	51	46
24	Bolivia	Hydrocarbons	53	80	47	63	32
25	Morocco	Minerals	53	48	60	56	42
26	Mongolia	Minerals	51	80	39	49	48
27	Tanzania	Minerals	50	44	48	68	42
28	Azerbaijan	Hydrocarbons	48	57	54	51	24
29	Iraq	Hydrocarbons	47	57	52	63	9
30	Botswana	Minerals	47	55	28	53	69
31	Bahrain	Hydrocarbons	47	38	40	59	58
32	Gabon	Hydrocarbons	46	60	51	39	28
33	Guinea	Minerals	46	86	45	43	11
34	Malaysia	Hydrocarbons	46	39	45	39	60
35	Sierra Leone	Minerals	46	52	47	59	24
36	China	Hydrocarbons	43	43	46	46	36
37	Yemen	Hydrocarbons	43	57	46	52	16
38	Egypt	Hydrocarbons	43	40	44	48	40
39	Papua New Guinea	Minerals	43	59	34	50	38
40	Nigeria	Hydrocarbons	42	66	38	53	18
41	Angola	Hydrocarbons	42	58	43	52	15
42	Kuwait	Hydrocarbons	41	28	43	36	57
43	Vietnam	Hydrocarbons	41	63	39	31	30
44	Congo (DRC)	Minerals	39	56	45	42	6
45	Algeria	Hydrocarbons	38	57	41	28	26
46	Mozambique	Hydrocarbons	37	58	26	37	37
47	Cameroon	Hydrocarbons	34	63	33	25	17
48	Saudi Arabia	Hydrocarbons	34	30	35	31	38
49	Afghanistan	Minerals	33	63	29	38	8
50	South Sudan	Hydrocarbons	31	80	17	35	8
51	Zimbabwe	Minerals	31	48	23	56	6
52	Cambodia	Hydrocarbons	29	52	13	46	20
53	Iran	Hydrocarbons	28	26	33	26	23
54	Qatar	Hydrocarbons	26	15	14	20	66
55	Libya	Hydrocarbons	19	11	29	15	10
56	Equatorial Guinea	Hydrocarbons	13	27	14	4	4
57	Turkmenistan	Hydrocarbons	5	13	4	0	3
58	Myanmar	Hydrocarbons	4	8	5	2	2

Source: Revenue Watch RGI

Notes

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Research ratings and important disclosures

Stock	ISIN	Disclosure (See Below)	Currency	Price
ABB	CH0012221716	nothing to disclose	CHF	20.16
Abbott Laboratories	US0028241000	nothing to disclose	USD	37.51
Abertis	ES0111845014	nothing to disclose	EUR	13.82
ACS	ES0167050915	nothing to disclose	EUR	21.09
Ahlstrom	FI0009010391	nothing to disclose	EUR	11.20
Alcatel-Lucent	FR0000130007	nothing to disclose	EUR	1.38
Alfa Laval	SE0000695876	nothing to disclose	SEK	138.50
Alliance Oil Co.SDB(OTC)	SE0000739286	nothing to disclose	USD	6.46
Alliance Oil SDB	SE0000739286	nothing to disclose	SEK	41.80
Alumina Spn.ADR 1:4	US0222051080	nothing to disclose	USD	3.77
Allianz	DE0008404005	nothing to disclose	EUR	116.90
Alstom	FR0010220475	nothing to disclose	EUR	27.60
AMEC	GB0000282623	nothing to disclose	GBP	999.50
Anglo American	GB00B1XZ5820	nothing to disclose	GBP	1,463.00
Anglogold Ashanti Spn. ADR 1:1	US0351282068	nothing to disclose	USD	16.81
Ansaldo STS	IT0003977540	nothing to disclose	EUR	7.75
Antofagasta	GB0000456144	nothing to disclose	GBP	639.00
ArcelorMittal	LU0323134006	nothing to disclose	EUR	9.50
Areva	FR0011027143	nothing to disclose	EUR	12.38
Assa Abloy	SE0000255648	nothing to disclose	SEK	260.30
Astaldi	IT0003261069	nothing to disclose	EUR	5.33
Atlas Copco	SE0000101032	nothing to disclose	SEK	164.30
Au Optronics	TW0002409000	nothing to disclose	TWD	12.30
Aus.And Nz.Banking Gp.	AU000000ANZ3	nothing to disclose	AUD	26.70
BAE Systems	GB0002634946	nothing to disclose	GBP	401.90
Balfour Beatty	GB0000961622	nothing to disclose	GBP	216.00
Banco Popular	ES0113790531	nothing to disclose	EUR	0.63
Barclays	GB0031348658	nothing to disclose	GBP	302.63
BBVA	ES0113211835	nothing to disclose	EUR	7.06
BG	GB0008762899	nothing to disclose	GBP	1,170.00
BHP Billiton	GB0000566504	nothing to disclose	GBP	1,825.00
Bilfinger	DE0005909006	nothing to disclose	EUR	78.48
BillerudKorsnas	SE0000862997	nothing to disclose	SEK	60.50
BNP Paribas	FR0000131104	nothing to disclose	EUR	44.44
Boliden	SE0000869646	nothing to disclose	SEK	94.50
Boskalis	NL0000852580	nothing to disclose	EUR	30.11
Bourbon	FR0004548873	nothing to disclose	EUR	20.62
Bouygues	FR0000120503	6	EUR	19.80
BP	GB0007980591	nothing to disclose	GBP	461.00
CAF	ES0121975017	nothing to disclose	EUR	317.40
CaixaBank	ES0140609019	nothing to disclose	EUR	2.72
CGG	FR0000120164	nothing to disclose	EUR	18.02
Cia.Minas Buenaventura ADR 1:1	US2044481040	nothing to disclose	USD	17.89
China Ptl.& Chm.'H' ADR 1:100	US16941R1086	nothing to disclose	USD	99.33
Citigroup	US1729674242	nothing to disclose	USD	51.60
CNOOC	HK0883013259	nothing to disclose		13.42
Commerzbank	DE000CBK1001	10, 14, 16, 18	EUR	7.66
Credit Suisse Group	CH0012138530	nothing to disclose	CHF	27.32
Daimler	DE0007100000	nothing to disclose	EUR	48.62
Danske Bank	DK0010274414	nothing to disclose	DKK	112.00
Dassault Aviation	FR0000121725	nothing to disclose	EUR	926.00
Deutsche Bank	DE0005140008	nothing to disclose	EUR	36.34
Deutsche Telekom	DE0005557508	nothing to disclose	EUR	8.84
EADS	NL0000235190	15, 17, 19	EUR	43.43
Ecopetrol	COC04PA00016	nothing to disclose	COP	4135.00
Eiffage	FR0000130452	nothing to disclose	EUR	36.30
Eli Lilly	US5324571083	nothing to disclose	USD	52.49
Ence	ES0130625512	nothing to disclose	EUR	2.36
ENI	IT0003132476	14, 16, 18	EUR	17.30
Eramet	FR0000131757	nothing to disclose	EUR	78.40
ERG	IT0001157020	nothing to disclose	EUR	7.47
Ericsson	SE0000108656	nothing to disclose	SEK	77.30
Eurasian Natres.Corp.	GB00B29BCK10	nothing to disclose	GBP	245.20
Essar Energy	GB00B5SXPF57	nothing to disclose	GBP	140.40
Evraz Highveld Stl.& Vnm.Sp.ADR 1:1	US30050Y1010	nothing to disclose	USD	1.60
FCC	ES0122060314	nothing to disclose	EUR	8.21
Ferrovial	ES0118900010	nothing to disclose	EUR	12.29
Finmeccanica	IT0003856405	14, 16, 18	EUR	4.09
France Telecom	FR0000133308	nothing to disclose	EUR	7.63
Fraport	DE0005773303	nothing to disclose	EUR	44.37
Galp	PTGALOAM0009	nothing to disclose	EUR	12.50
GlaxoSmithKline	GB0009252882	nothing to disclose	GBP	1,662.50

Source: Factset closing prices of 07/06/2013

Stock prices: Prices are taken as of the previous day's close (to the date of this report) on the home market unless otherwise stated.

Stock	ISIN	Disclosure (See Below)	Currency	Price
Glencore Xstrata	JE00B4T3BW64	nothing to disclose	GBP	315.05
Goldfield	US3813701055	nothing to disclose	USD	2.48
Goldman Sachs Gp.	US38141G1040	nothing to disclose	USD	166.01
Halliburton	US4062161017	nothing to disclose	USD	43.16
Harmony Gd.Mng.Co.ADR 1:1	US4132163001	nothing to disclose	USD	4.08
Hochtief	DE0006070006	nothing to disclose	EUR	50.58
Holmen	SE0000109290	nothing to disclose	SEK	178.00
HSBC	GB0005405286	nothing to disclose	GBP	380.60
Impregilo	IT0003865570	nothing to disclose	EUR	2.98
ING Group	NL0000303600	nothing to disclose	EUR	6.97
Intesa Sanpaolo	IT0000072618	nothing to disclose	EUR	1.40
JGC	JP3667600005	nothing to disclose	JPY	3170.00
JM	SE0000806994	nothing to disclose	SEK	144.25
JP Morgan Chase & Co.	US46625H1005	nothing to disclose	USD	54.27
Kone	FI0009013403	nothing to disclose	EUR	65.90
KPN	NL0000009082	nothing to disclose	EUR	1.55
Legrand	FR0010307819	6, 14, 16, 18	EUR	35.70
LloydsTSB	GB0008706128	nothing to disclose	GBP	62.76
Lundin Petroleum	SE0000825820	nothing to disclose	SEK	138.90
Magyar Tkom.Telecom.	HU0000073507	nothing to disclose	HUF	359.00
MAN	DE0005937007	nothing to disclose	EUR	83.92
Mechel Oao SPN.ADR 1:1	US5838401033	nothing to disclose	USD	2.91
Mechel Oao SPN.ADR 2:1 Preferred Shs.	US5838405091	nothing to disclose	USD	0.98
Maurel & Prom	FR0000051070	nothing to disclose	EUR	12.46
Mayr Melnhof Karton	AT0000938204	nothing to disclose	EUR	83.40
Meggitt plc	GB0005758098	nothing to disclose	GBP	519.50
Metsa Board	FI0009000665	nothing to disclose	EUR	2.46
Millicom	LU0038705702	nothing to disclose	USD	78.07
MTU Aero Engines	DE000A0D9PT0	nothing to disclose	EUR	76.05
Neste Oil	FI0009013296	nothing to disclose	EUR	10.91
Nexans	FR0000044448	nothing to disclose	EUR	38.66
Nordea Bank	SE0000427361	nothing to disclose	SEK	80.40
Norske Skog	NO0004135633	nothing to disclose	NOK	2.46
Norsk Hydro	NO0005052605	nothing to disclose	NOK	26.80
OHL	ES0142090317	nothing to disclose	EUR	28.65
OMV	AT0000743059	nothing to disclose	EUR	35.89
Orkla	NO0003733800	nothing to disclose	NOK	49.40
Panalpina	CH0002168083	nothing to disclose	CHF	97.40
Petrobras	BRPETRACNPR6	nothing to disclose	BRL	18.84
Petrobras Argentina C.I.B ADR 1:10	US71646J1097	nothing to disclose	USD	4.22
Petrochina SPN.ADR 1:100	US71646E1001	nothing to disclose	USD	115.20
Pfizer	US7170811035	nothing to disclose	USD	28.26
PGS	NO0010199151	nothing to disclose	NOK	84.50
Philips	NL0000009538	nothing to disclose	EUR	21.24
Prysmian	IT0004176001	nothing to disclose	EUR	15.40
Randgold Res.Ads ADR 1:1	US7523443098	nothing to disclose	USD	77.30
Repsol	ES0173516115	nothing to disclose	EUR	17.38
Rexel	FR0010451203	nothing to disclose	EUR	17.17
Rheinmetall	DE0007030009	nothing to disclose	EUR	37.91
Rio Tinto	GB0007188757	nothing to disclose	GBP	2,337.05
Rolls Royce Holdings	GB00B63H8491	nothing to disclose	GBP	1,174.00
Royal Dutch Shell	GB00B03MLX29	nothing to disclose	EUR	24.81
SAAB 'B'	SE0000112385	nothing to disclose	SEK	133.40
Sacyr	ES0182870214	nothing to disclose	EUR	2.13
Safran	FR0000073272	nothing to disclose	EUR	39.69
Saipem	IT0000068525	nothing to disclose	EUR	20.17
Sandvik	SE0000667891	nothing to disclose	SEK	86.95
Santander	ES0113900J37	nothing to disclose	EUR	5.47
Saras	IT0000433307	nothing to disclose	EUR	1.12
Sasol SPN.ADR. 1:1	US8038663006	nothing to disclose	USD	44.34
SBM Offshore	NL0000360618	nothing to disclose	EUR	13.90
SCA	SE0000112724	nothing to disclose	SEK	168.30
Schneider Electric	FR0000121972	nothing to disclose	EUR	58.57
Sibanye Gold	ZAE000173951	nothing to disclose	ZAR	9.16
Siderurgica Nacional On ADR 1:1	US20440W1053	nothing to disclose	USD	2.94
Siemens	DE0007236101	nothing to disclose	EUR	80.33
Skanska	SE0000113250	nothing to disclose	SEK	116.50
Smiths Group	GB00B1WY2338	nothing to disclose	GBP	1,304.00
SmurfitKappa	IE00B1RR8406	nothing to disclose	EUR	11.77
SNAM	IT0003153415	14, 16, 18	EUR	3.49
Société Générale	FR0000130809	nothing to disclose	EUR	30.15
Standard Chartered	GB0004082847	nothing to disclose	GBP	1,838.67
Statoil	NO0010096985	nothing to disclose	NOK	129.30
Sterlite Inds.ADR 1:4	US8597372072	nothing to disclose	USD	6.27
Stora Enso	FI0009005961	nothing to disclose	EUR	5.29

Source: Factset closing prices of 07/06/2013

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Stock	ISIN	Disclosure (See Below)	Currency	Price
Subsea 7	LU0075646355	nothing to disclose	NOK	130.40
Svenska Handelsbanken	SE0000193120	nothing to disclose	SEK	284.90
Technip	FR0000131708	6	EUR	84.69
Tele2	SE0000314312	nothing to disclose	SEK	108.00
Telecom Italia	IT0003497168	nothing to disclose	EUR	0.58
Telefonica	ES0178430E18	14, 16, 18	EUR	10.44
Telekom Austria	AT0000720008	nothing to disclose	EUR	5.22
Telenor	NO0010063308	nothing to disclose	NOK	121.50
TeliaSonera	SE0000667925	nothing to disclose	SEK	44.15
Tenaris	LU0156801721	nothing to disclose	EUR	16.01
Thales	FR0000121329	nothing to disclose	EUR	37.89
ThyssenKrupp	DE0007500001	nothing to disclose	EUR	15.55
Tognum	DE000AON4P43	nothing to disclose	EUR	27.91
Total	FR0000120271	nothing to disclose	EUR	37.90
Tullow Oil plc	GB0001500809	nothing to disclose	GBP	1,004.00
Técnicas Reunidas	ES0178165017	nothing to disclose	EUR	36.70
UBS	CH0024899483	nothing to disclose	CHF	16.95
Unicredit	IT0004781412	2, 14, 18, 19	EUR	4.07
UPM	FI0009005987	6	EUR	7.89
Vale On ADR 1:1	US91912E1055	nothing to disclose	USD	14.51
Vallourec	FR0000120354	nothing to disclose	EUR	39.52
Vinci	FR0000125486	nothing to disclose	EUR	39.79
Vodafone Group	GB00B16GWD56	nothing to disclose	GBP	191.85
Vopak	NL0009432491	nothing to disclose	EUR	46.40
Weir Group	GB0009465807	nothing to disclose	GBP	2,181.00
WSP Group Plc	GB0009323741	nothing to disclose	GBP	433.75
Yanzhou Coal Mng. 'H' Spn.ADR 1:10	US9848461052	nothing to disclose	USD	10.13
Ypf 'D' Spn.ADR 1:1	US9842451000	nothing to disclose	USD	15.17
Zodiac Aerospace	FR0000125684	nothing to disclose	EUR	100.65

Source: Factset closing prices of 07/06/2013

Stock prices: Prices are taken as of the previous day's close (to the date of this report) on the home market unless otherwise stated.

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Total	100.0%	0.0%

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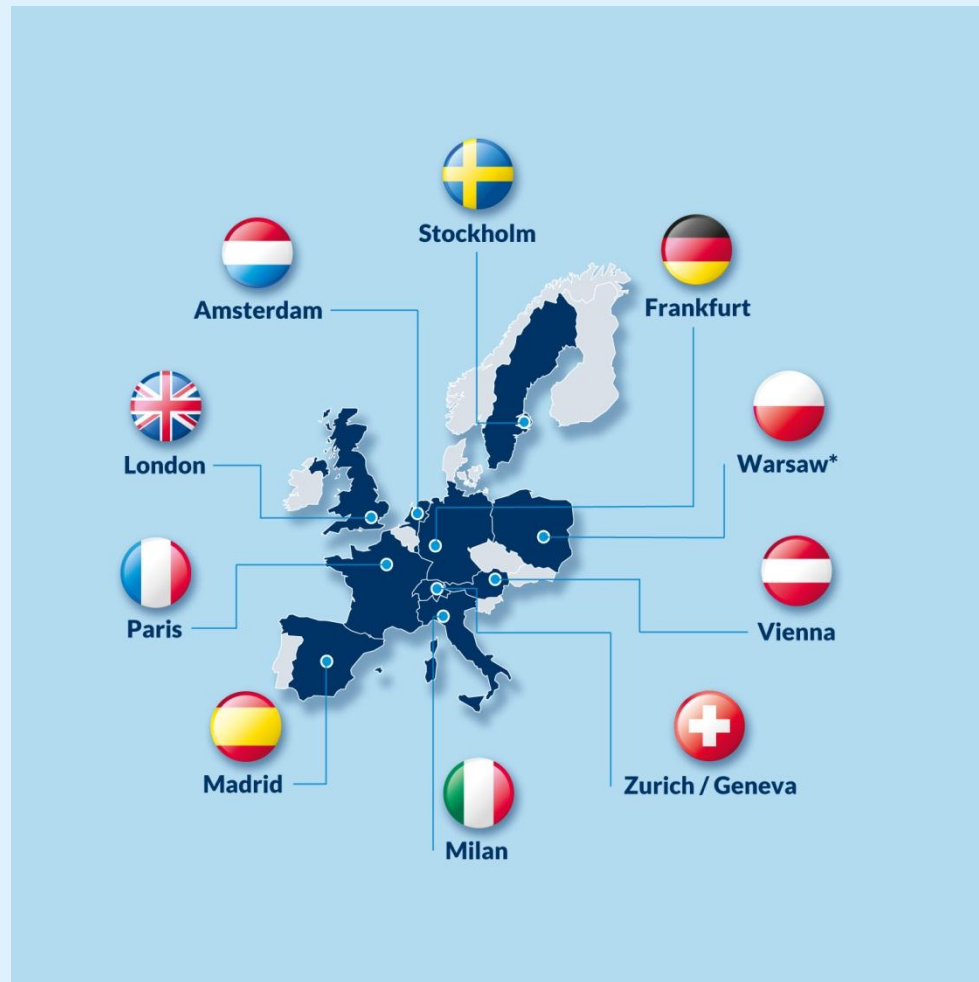
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