Decision to exclude from investments

1 June 2015

Introduction

KLP and the KLP Funds (KLP) have decided to exclude the company China Railway Group from their investment portfolios in with effect from 1 June 2015.

China Railway Group Ltd (CRG) is a state-owned Chinese construction company.[1] Although its main business is in China, CRG's website says it has operated in more than 55 countries since the 1970s.[2]

As at 31 December 2014, KLP and the KLP Funds held CRG shares worth approx. NOK 5,960,000.[3]

The incident and the company's involvement

KLP's decision to consider a possible divestment of shares in China Railway Group was prompted by *Recommendation No. 10 October 2014 to exclude China Railway Group Ltd*, published by the Norwegian Government Pension Fund Global's Council on Ethics.[4] The recommendation was announced in connection with publication of the Council on Ethics' 2014 annual report. The Norwegian Ministry of Finance has made no decision on the matter, since CRG was not among the GPFG's shareholdings as of 1 January 2015.

A detailed description of the incident can be found in the Council on Ethics' recommendation.[5] Based on reports of the legal judgment and the Chinese Communist Party's internal disciplinary proceedings published in the Chinese press, there are clear indications that the company has been involved in gross corruption, including the payment of bribes to public servants in China, to

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[1] China Railway Group, "Corporate Introduction", http://www.crecg.com/en/tabid/176/Default.aspx (last visited 23 February 2015).

[2] Ibid.

[3] Based on the share price and exchange rates in effect on 9 February 2015.

[4] Council on Ethics (10 October 2014), *Recommendation to exclude China Railway Group Ltd. (CRG).* URL: http://etikkradet.no/tilradning-10-oktober-2014-om-utelukkelse-av-china-railway-group-ltd/

[5] Ibid.

secure the award of railway contracts to CRG.[6] These judicial and disciplinary proceedings have been directed at the recipients, who have been punished for corruption. The Council on Ethics' recommendation relies on press sources, since the primary documents themselves have not been made public.

With respect to whether the company has introduced routines that may reduce the future risk, the Council on Ethics was obliged to rely on CRG's website, since the company failed to reply to the Council's queries.[7] The routines described on CRG's website must be deemed inadequate.[8] There is, for example, no external whistleblowing mechanism, and the anticorruption guidelines do not apply to all employees.[9] Furthermore, CRG's executive management team is more or less the same as when the corrupt practices took place.[10] Finally, CRG operates in a sector and in a country that are heavily exposed to corruption, which raises the minimum standard for what can reasonably be expected with regard to corruption prevention measures.[11] The Council on Ethics summarises its conclusions thus:

> *In that CRG is involved in one of the most serious corruption cases in China, is still managed by the same people who managed it when the acts of corruption took place and who knew or ought to have known about the acts, and is still operating in countries heavily exposed to corruption without at the same time making it clear that it is trying to prevent future violations, the Council believes there is an unacceptable risk of CRG being involved in future cases of gross corruption.*[12]

All this underpins the presumption of an unacceptable risk of future acts of corruption.

Dialogue

KLP requested a meeting with CRG to discuss the contents of the Council on Ethics' *Recommendation*. The company replied that it would consider the invitation and respond

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[6] Ibid., p. 1-2.
[7] Ibid., p. 1.
[8] Ibid., s. 14.
[9] Ibid., p. 10-11.
[10] Ibid., p. 15.
[11] Ibid., p. 13.
[12] Ibid., p. 15.

shortly.[13] KLP received no such response, and the original query was followed up with two written reminders. The company has not replied to any of KLP's communications.

Guidelines and assessment

One of the grounds for divestment stipulated in KLP's Guidelines for Responsible Investment is the existence of an "unacceptable risk that the company is complicit in or is itself responsible for… gross corruption".[14] In addition, KLP follows the example of the GPFG when it excludes companies on the advice of the Council on Ethics.

In this case, the Norwegian Ministry of Finance has not made a decision with respect to the Council's recommendation, since the GPFG was no longer invested in the company when decision-making authority was transferred from the Ministry of Finance to Norges Bank. However, KLP *was* invested in CRG at the time the recommendation was published, and was therefore obliged to come to a conclusion on the matter. This is a new situation, since no recommendation has before been published on which the Ministry of Finance has not made a decision. Nevertheless, it is our practice to give considerable weight to the Council on Ethics' recommendations, unless there are strong reasons not to – for example, that the company has implemented improvements since the recommendation was written.

KLP considers the Council on Ethics' analysis and conclusion to be very well founded, and sees no reason to depart from its recommendation unless conditions at CRG have materially changed since the recommendation was written in October 2014. KLP finds nothing to substantiate any such assumption, nor has the company replied to KLP's queries.

For the above-mentioned reasons, therefore, there is in our opinion an unacceptable risk that CRG has been involved in gross corruption, and that the company has still not implemented corruption-prevention measures capable of reducing the risk of such practices being repeated.

Decision

China Railway Group Ltd. is excluded from investment by KLP and the KLP Funds with effect from 1 June 2015.

[13] A Chinese-speaking consultant from KLP's service provider GES-Invest Services telephoned China Railway Group on 10 February 2015.

[14] KLP's Guidelines for Responsible Investment (last updated in 2014).