

To the Ministry of Finance

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Date: 3 September 2008

### **The Council on Ethics' recommendation to exclude Siemens AG**

We refer to the Ministry of Finance's letter of 5 May 2008, in which the Ministry requests the Council to comment on and assess new information on Siemens that has come to light after the Council, on 15 November 2007, submitted its recommendation to exclude Siemens from the GPF's portfolio. The Ministry's letter makes reference to new information available in Siemens' Annual Report, which was made public after the recommendation had been submitted. In this reply, the Council provides a summary of the main elements in its recommendation, followed by an account of the new information in Siemens' Annual Report. Finally, there is an appraisal of new information from other sources that have a bearing on the Council's conclusion in this case. The key question is whether Siemens' announced measures and other information that has emerged after the recommendation was submitted give reason to believe that there no longer is an unacceptable risk of contribution to future corruption.

#### *The recommendation of 15 November 2007*

The Council has worked on this case since the summer of 2006. In its recommendation for exclusion, dated 15 November 2007, the Council gave an account of Siemens' use of gross corruption. Moreover, the Council assessed the risk of future corruption. In view of Siemens' record of several convictions for corruption, numerous ongoing corruption investigations, as well as the extensive and systematic nature of the corrupt practices, the Council concluded that the Guidelines' criterion of gross corruption must be regarded as being met.

In its recommendation, the Council assessed the measures Siemens so far had announced in order to prevent future corruption. The company's chief executive and chairman had been replaced, and an ombudsman system had been established, as well as a Compliance Committee and a Disciplinary Committee. Moreover, a Legal and Compliance Executive had been recruited externally and protected communication channels had been created for whistle-blowers. Siemens had also engaged an American law firm, Debevoise and Plimpton, to carry out an internal investigation of the corruption accusations against the company. The law firm reports both to the Compliance Committee and to the SEC in the USA.<sup>1</sup>

The company had also announced organisational measures designed to reduce the risk of corruption, such as the centralization of payments to control the cash flow. New consultancy agreements were to be approved by staff at various levels, and large contracts ought to be

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<sup>1</sup> Securities and Exchange Commission.

signed at the division level and not nationally. Management restructuring had been announced as well.

Based on an overall assessment, the Council found that the measures did not seem sufficiently far-reaching to reduce the risk of future corruption. Previous experiences with the company's anti-corruption efforts had a significant bearing on this evaluation. In the early 1990s, corruption was revealed at Siemens, but despite extensive anti-corruption measures in the wake of this scandal, the corrupt practices prevailed. The company's reaction to the new revelations was, in the Council's view, characterized by an underestimation of the seriousness of the case. In its assessment, the Council attached importance to the fact that persons who according to their position should have acted in order to prevent the corrupt practices continued in key company positions despite their failure to do so. At the time, it was also unclear whether the company would impose sufficiently strict sanctions on employees who were involved in corruption, such as reporting them to the police.

#### *New information in Siemens' Annual Report 2007*

According to the Annual Report released in November 2007, the company has implemented various measures to improve its compliance procedures and control mechanisms as a result of the corruption accusations. The majority of these measures had already been made public by the time the Council submitted its recommendation and were thus assessed in the recommendation. Some new measures are nevertheless presented in the Annual Report, and these are briefly described below.

According to the Annual Report, the company's Audit and Compliance Committee was carrying out an internal analysis of the company's compliance procedures and internal control mechanisms with a view to uncovering possible weaknesses. Moreover, all the company's auditing functions had been merged into one Corporate Finance Department. A Chief Audit Officer was appointed for the department, with an independent reporting line to the Audit Committee and its leader.<sup>2</sup> A new Chief Compliance Officer (CCO) had been appointed as the former CCO was dismissed in August 2007.<sup>3</sup> The CCO heads the compliance organisation and reports directly to the board member responsible for compliance as well as to the chairman. In addition, a training programme had been created, aimed at staff at various levels.<sup>4</sup> As of 3rd quarter 2008, 30,000 employees are supposed to have participated in compliance courses, and 108,000 have taken an online course in the same area.<sup>5</sup>

The Annual Report also announced that an amnesty programme would be launched in December 2007, offering the employees a three-month period to report on corruption in the company without the risk of being sued for damages or dismissed, even if they had been personally complicit in the corrupt practices. However, the company reserved the right to impose other disciplinary sanctions on employees, and the amnesty would not prevent criminal prosecution if the whistle-blower had been guilty of any criminal offence.<sup>6</sup> According to Siemens, 123 employees have made use of the offer as of 3rd quarter 2008, and among these 67 have been granted amnesty.<sup>7</sup>

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<sup>2</sup> Siemens' Annual Report 2007, page 166.

<sup>3</sup> Compliance Magazin, 11 September 2007: "Siemens: Schäfer klagt gegen Kündigung":  
<http://www.compliancemagazin.de/markt/personen/siemens110907.html>

<sup>4</sup> Siemens' Annual Report 2007, page 166.

<sup>5</sup> Siemens' Fortschrittsbericht (Q3 FY 2008):  
<http://w1.siemens.com/responsibility/pool/compliance/q3-08-compliance-progress-report-d.pdf>

<sup>6</sup> Siemens' Annual Report 2007, page 167.

<sup>7</sup> Siemens' Fortschrittsbericht (Q3 FY 2008):

### *Other new information*

In November 2007, the new CEO, Mr. Löscher, declared that the scope of bribery now seemed to have been uncovered in its entirety.<sup>8</sup> In the period following his statement, the Munich prosecutors have extended the investigation to include five new units, and investigations have been launched in several new countries.<sup>9</sup> Debevoise and Plimpton has found proof of corruption and other serious violations in nearly all the investigated units.<sup>10</sup> The corruption accusations have also been shifted further up the system. The Public Prosecutor's Office in Munich has given 270 present and former Siemens employees status as suspects in the case.<sup>11</sup>

Siemens' management decided in April this year to bring a civil claim for damages against eleven former directors at Siemens, including Mr. von Pierer, former CEO and chairman, and Mr. Kleinfeld, former CEO, because they had neglected their organisational and supervisory duties with regard to the prevention of illegal business practices and bribery.<sup>12</sup>

To prevent corruption, the company has also announced that 450 anti-corruption experts will be allocated to its units.<sup>13</sup> After the Annual Report was presented, it has emerged that Siemens has centralized the compliance organisation in order to strengthen its compliance processes,<sup>14</sup> seeing as the company has previously faced criticism that this structure was very fragmented and understaffed. The mandate of those responsible for compliance has also been very unclear and restricted, something that has hamstrung the compliance organisation as a whole.<sup>15</sup> Moreover, compliance department staff has had a conflicting mandate in that, on the one hand, they were expected to take care of the company's anti-corruption efforts, and on the other they had to defend the company externally if corruption cases became known to the public.<sup>16</sup> Based on the information from Siemens, it seems unclear whether the centralization of the compliance organisation has changed this. According to Siemens, the new compliance organisation has been established at the company headquarters, but the various company units and regions are working on implementing the new structure. Previously, the responsibility for

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<http://w1.siemens.com/responsibility/pool/compliance/q3-08-compliance-progress-report-d.pdf>

<sup>8</sup> Der Spiegel, 8 November 2007: "Siemens straft 470 Mitarbeiter ab"

<http://www.spiegel.de/wirtschaft/0,1518,516091,00.html>

<sup>9</sup> Siemens' legal proceedings - third quarter fiscal 2008:

<http://w1.siemens.com/press/pool/de/events/2008-q3/2008-q3-legal-proceedings-e.pdf>

<sup>10</sup> Siemens press release 29 April 2008:

[http://w1.siemens.com/press/en/pressrelease/2008/corporate\\_communication/axx20080447.htm](http://w1.siemens.com/press/en/pressrelease/2008/corporate_communication/axx20080447.htm)

<sup>11</sup> Die Welt, 26 May 2008: "Jetzt packt Reinhard S. im Siemens-Skandal aus":

[http://www.welt.de/wirtschaft/article2033882/Jetzt\\_packt\\_Reinhard\\_S.\\_im\\_Siemens-Skandal\\_aus.html](http://www.welt.de/wirtschaft/article2033882/Jetzt_packt_Reinhard_S._im_Siemens-Skandal_aus.html)

<sup>12</sup> Siemens' legal proceedings - third quarter fiscal 2008:

<http://w1.siemens.com/press/pool/de/events/2008-q3/2008-q3-legal-proceedings-e.pdf>

Der Spiegel, 29 July 2008: "Siemens verlangt Schadenersatz von Pierer und zehn Ex-Vorstandsmitgliedern",

<http://www.spiegel.de/wirtschaft/0,1518,568751,00.html>

<sup>13</sup> Siemens Compliance Fortschrittsbericht (Q2 FY 2008):

<http://w1.siemens.com/press/pool/de/events/2008-q3/2008-q3-compliance-fortschrittsbericht-d.pdf>

<sup>14</sup> Compact Quarterly, 14 July 2008: "A new Direction for Siemens" by Andreas Pohlmann, CCO, Siemens.

[http://www.enebuilder.net/globalcompact/e\\_article001149152.cfm?x=bd2Hd2m.b4NW9bGV,w](http://www.enebuilder.net/globalcompact/e_article001149152.cfm?x=bd2Hd2m.b4NW9bGV,w)

<sup>15</sup> Der Spiegel, 16 August 2008: "Neue Studie belastet Ex-Siemens-Vorstand":

<http://www.spiegel.de/wirtschaft/0,1518,572482,00.html>

Witness statements from the lawsuit against Reinhard S. in Munich, June 2008. The Secretariat's notes from the courtroom are on file with the Council.

<sup>16</sup> Der Spiegel, 16 August 2008: "Neue Studie belastet Ex-Siemens-Vorstand":

<http://www.spiegel.de/wirtschaft/0,1518,572482,00.html>

compliance did not lie with the corporate management, but this was changed in October 2007 when Siemens created a board position for legal and compliance matters. It is also said that compliance-related goals have been integrated into the system of incentives for top management in the company's various units.<sup>17</sup>

According to Siemens, the general organisational structure is now transparent and is supposed to have clear areas of responsibility based on explicit commando lines. In part, this has been done by merging the company's former eleven divisions into three new main sectors called Health, Energy and Industry. In this connection, part of the management has been replaced. Some of the resigned management members have, however, entered into consultancy agreements with Siemens instead.<sup>18</sup> Three of the new management members have been recruited externally; the remaining five come from various units within Siemens. On the board, eight out of twenty members have been replaced.

#### *The Council's assessment*

In its recommendation of 15 November 2007, the Council advocated exclusion, concluding that pursuant to the Guidelines there was gross, far-reaching, and systematic corruption at Siemens, as well as an unacceptable risk that the Fund, through its ownership in Siemens, would contribute to future corruption. The question is whether there still is an unacceptable risk of contributing to future gross corruption, considering the new anti-corruption measures that have been implemented after the recommendation for exclusion was submitted on 15 November 2007.

The Council sustains that since November 2007 the scale of uncovered corruption at Siemens has increased significantly, something that is shown through investigations of new units in several new countries. At present, a large number of Siemens' units are under investigation, and in the Munich case alone 270 current and former Siemens employees are at the moment suspected in the case. The criminal proceedings are expected to continue during the autumn of 2008. In other words, the corruption has turned out to be more far-reaching and systematic than what the Council took as a point of departure for its recommendation of 15 November 2007.

Since the corruption case was revealed, Siemens has introduced several measures that may be expected to contribute to reducing the risk of further corruption in the company. In particular, the Council will call attention to the creation of protected communication channels for whistle-blowing. It is crucial that people within the company are able to report on corruption without running the risk that the alert may be traced back to them. As pointed out in the recommendation, several former employees at Siemens have come forward with accusations of corrupt practices in the company without the management taking it seriously. In some cases, Siemens is said to have dismissed the whistle-blower and offered him consultancy assignments in return for not taking the case further.<sup>19</sup>

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<sup>17</sup> Compact Quarterly, 14 July 2008: "A new Direction for Siemens" by Andreas Pohlmann, CCO, Siemens: [http://www.enebuilder.net/globalcompact/e\\_article001149152.cfm?x=bd2Hd2m.b4NW9bGV.w](http://www.enebuilder.net/globalcompact/e_article001149152.cfm?x=bd2Hd2m.b4NW9bGV.w).

<sup>18</sup> Siemens press release 28 November 2007:

[http://w1.siemens.com/press/en/pr\\_cc/2007/11\\_nov/axx20071115.htm](http://w1.siemens.com/press/en/pr_cc/2007/11_nov/axx20071115.htm)

Süddeutsche Zeitung, 25 June 2008: "Beratervertrag mit Ex-Vorstand Sharef gekündigt":

<http://www.sueddeutsche.de/wirtschaft/artikel/128/182561/>

<sup>19</sup> Stern, Heft 49, 2006: "Mit Stumpf und Stiel":

<http://www.stern.de/wirtschaft/unternehmen/unternehmen/Siemens-Mit-Stumpf-Stiel/577903.html>

Per-Yngve Monsen, 2008, "Muldvarp i Siemens".

The external analysis of compliance procedures and control mechanisms, and the company's centralization of the compliance organisation seem positive. The court case in Munich has revealed that several lawyers in the Compliance Office were aware of the corruption, but they did not have a mandate to initiate investigations or impose sanctions related to breaches of internal rules, and therefore nothing was done.<sup>20</sup> In order to prevent future corruption, it is now of great importance that the company manages to establish a functioning compliance organisation with clear-cut areas of responsibility and commando lines. However, the Council notes that the Audit Committee is still made up of much the same persons who did not succeed in detecting ongoing corruption at the company before. In the Council's view, it is therefore uncertain whether the changes will lead to corruption now being detected.

Furthermore, some replacements have been made among management and board members. The Council finds that the decision to make former managers personally liable for damages related to the corrupt practices is a reaction which may have a preventive effect, indicating that the company tries to weed out the corruption. Nevertheless, the Council notices that Siemens has given some dismissed managers consultancy assignments after their dismissal.

As in the recommendation of 15 November 2007, the Council finds it pertinent to assess Siemens' new anti-corruption measures against the background of the corruption revelations in the 1990s and the extensive anti-corruption measures that were implemented at that time.<sup>21</sup> The ongoing investigation has revealed that while these measures were being implemented in the 1990s, Siemens employees continued the practice of bribery to secure company contracts. When Siemens was listed on the New York Stock Exchange in 2001, a completely new compliance organisation was put in place to fulfil American requirements. Three years previously, Siemens had become a member of Transparency International, whose membership requirements include zero tolerance and active anti-corruption efforts. From the Munich court case it has emerged that employees were nonetheless asked to set up new and more ingenious systems for bribery.<sup>22</sup> The internal investigation has uncovered that in the period 2000 to 2006 EUR 1.3 billion have been spent on possible bribes to secure contracts for the company.<sup>23</sup> In view of these experiences, the Council still finds it uncertain whether current measures will be effective and sufficient to prevent future corruption in the company.

The Council also makes a note of the fact that the new corruption revelations did not come as a result of internal investigations where the company itself notified the authorities, but because of the public prosecutor's raid at Siemens' headquarters in Munich. The Council finds that the company has shown a passive attitude in face of the detected corruption. It has only confessed insofar as it has been exposed in the media. Only after the SEC initiated a formal investigation of the company did Siemens feel obliged to act and implement various

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<sup>20</sup> Witness statements from the lawsuit against Reinhard S. in Munich, June 2008. The Secretariat's notes from the courtroom are on file with the Council.

<sup>21</sup> Handelsblatt, 15 December 2006: "Korruption ist bei Siemens nichts Neues":

<http://www.handelsblatt.com/unternehmen/industrie/korruption-ist-bei-siemens-nichts-neues;1186555>

ZDF, 12 December 2006: "Siemens räumt Korruption ein":

<http://www.heute.de/ZDFheute/inhalt/23/0,3672,4089591,00.html>

<sup>22</sup> Witness statements from the lawsuit against Reinhard S. in Munich, June 2008. The Secretariat's notes from the courtroom are on file with the Council.

Die Welt, 26 May 2008: "Siemens-Manager belastet seine Vorgesetzten":

[http://www.welt.de/wirtschaft/article2034809/Siemens-Manager\\_belastet\\_seine\\_Vorgesetzten.html](http://www.welt.de/wirtschaft/article2034809/Siemens-Manager_belastet_seine_Vorgesetzten.html)

<sup>23</sup> Der Tagesspiegel, 9 November 2007 "Siemens schmierte mit 1,3 Milliarden":

<http://www.tagesspiegel.de/wirtschaft/Unternehmen-Siemens-Schmiergeldskandal;art129,2416493>

anti-corruption measures. It seems to be a characteristic trend that Siemens only starts the clean-up once it is forced to, and not on its own initiative.

As a multinational company with more than 400 000 employees in 190 countries, Siemens faces great challenges when it comes to changing its corporate culture. The extensive scale of corruption cases and the reluctant way in which the company has dealt with the detected instances of corruption, together with CEO Peter Löscher's misjudgement of the scope as late as November 2007, imply that the risk of future corruption still seems unacceptably high. The Council therefore maintains its recommendation to exclude Siemens AG from the GPF's portfolio.

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Gro Nystuen Chair (sign.)	Andreas Føllesdal (sign.)	Anne Lill Gade (sign.)	Ola Mestad (sign.)	Bjørn Østbø (sign.)
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