Briefing
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Natural Resource Governance Institute

Publish What You Pay

Commodities Trading Transparency

Game-Changing Opportunity for U.K. Leadership at the London Anti-Corruption Summit

Currently subject to limited regulation and even fewer reporting requirements, companies engaged in physical commodity trading of oil, gas and minerals should be required to publicly report on their transactions with government entities.

The U.K. is well-positioned to champion this issue at the Anti-Corruption Summit to be hosted by Prime Minister David Cameron in London on 12 May 2016. *The U.K. should commit to revising its own reporting requirements to include these transactions, advocate for EU-level change, and lead an international process to end trading secrecy that includes other major trading hubs like Switzerland, Singapore and the United States.*

Payments related to commodity trading are economically significant, usually secret, and prone to corruption. In most oil-producing countries, the state receives a share of production, which is typically then sold by the national oil company. In some cases the sale proceeds represent the country's largest revenue stream. From 2011 to 2013, the total value of sales by the national oil companies of Africa's 10 top oil producers was equal to 56 percent of their combined government revenues (more than 10 times international aid to these countries).[1] In countries like Iraq, Nigeria, Libya and Angola, the majority of *total* government revenues come from crude oil sales, and many of the trades are made with UK, other EU, US or Swiss companies.

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Despite their size, these transactions usually take place in secret, and this opacity has been abused. Corruption can occur in the sale transactions themselves. For example, the former head of Indonesia's oil sector regulatory body faces a jail sentence for accepting bribes from a company seeking oil trading contracts.[2] Corrupt oil deals signed by the previous Nigerian government lost the country as much as $16 per barrel, and have since been cancelled by the Buhari administration.[3] Secrecy in oil sales also lets governments hide how much revenue they receive. In Angola, for instance, the IMF revealed that the national oil company had illegally and secretly spent $32 billion in oil sale revenues between 2007 and 2010 – funds that should

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1 Natural Resource Governance Institute, Swissaid and Berne Declaration, *Big Spenders – Swiss Trading Companies: African Oil and the Risks of Opacity*, 2014. http://www.resourcegovernance.org/sites/default/files/BigSpenders_20141014.pdf

2 *Wall Street Journal*, "Further Corruption Probe Seen for Indonesian Oil and Gas Regulator," 30 April 2014. http://www.wsj.com/articles/SB10001424052702303948104579533472824176590

3 NRGI, *Inside NNPC Oil Sales: A Case for Reform in Nigeria*, August 2015. http://www.resourcegovernance.org/publications/inside-nnpc-oil-sales

have entered the public budget.[4] Further examples are available in the May 2016 NRGI briefing: *Governance and Corruption Risks in Oil and Gas Trading*.[5]

These corruption risks have been acknowledged:

- The Africa Progress Panel, chaired by former UN Secretary-General Kofi Annan, notes that international action is urgently needed to make oil, gas and mineral trading more transparent and accountable.[6]
- A letter published in the *Financial Times* on 14 April 2016 from Sir Paul Collier, Baroness Valerie Amos and others identified this issue as a priority for the London summit.[7]
- The UK Financial Conduct Authority has identified due diligence gaps in commodity trading enabling corruption, "financial crime risk" and "heightened reputational risk" for trading companies.[8]
- The Swiss government has recognized the reputational risk posed by hosting such a large sector, noting that "the commodities industry is. . .associated with. . . challenges that must be taken seriously, including the need to respect human rights and environmental standards in resource-exporting countries and the problem of governance deficiencies in many of those countries. These challenges may also bring with them reputational risks both for individual companies and for Switzerland."[9]
- The Organisation for Economic Co-operation and Development (OECD) emphasizes the corruption risks around commodity trading in its April 2016 report on corruption in the extractive sector.[10]
- NGOs have exposed the link between commodities traders and politically exposed persons, as well as the lack of due diligence requirements to "know your customer" in the sector.[11, 12]

Despite this awareness, policy responses have been lacking. The kind of extensive regulation and reporting required in the derivatives market is wholly absent from the physical commodities trading market, which remains a "wild west" frontier. Especially with low prices causing desperation among energy producers, high-risk

4 IMF, Angola - *Fifth Review under the Stand-By Arrangement*, 2011. https://www.imf.org/external/pubs/ft/scr/2011/cr11346.pdf
5 Natural Resource Governance Institute, *Governance and Corruption Risks in Oil and Gas Trading*, 2016.
6 Africa Progress Panel, *Equity in Extractives*, 2013, p. 97: "All countries should adopt and enforce the project-by-project disclosure standards of the US Dodd-Frank Act and comparable EU legislation, applying them to all extractive industry companies listed on their stock exchanges. *These standards should also include commodity trading."* [emphasis added] Available at: http://app-cdn.acwupload.co.uk/wp-content/uploads/2013/08/2013_APR_Equity_in_Extractives_25062013_ENG_HR.pdf
7 Letter from Baroness Valerie Amos et al, *Eight steps towards ending corruption*, 14 April 2016: "Companies buying oil, gas and minerals...must make details of their payments to any government... available to the public." https://next.ft.com/content/03dd6d6c-0229-11e6-99cb-83242733f755
8 FCA, Commodity Markets Update, February 2014, http://www.fca.org.uk/static/documents/commodity-market-update-1402.pdf, 9.
9 Swiss Federal Department of Foreign Affairs, *Background Report: Commodities*, March 2013, 42, http://www.news.admin.ch/NSBSubscriber/message/attachments/30136.pdf
10 OECD, *Corruption in the Extractive Value Chain: Typology of Risks*, Mitigation Measures and Incentives, April 2016, 82. http://www.oecd.org/dev/Corruption-in-the-extractive-value-chain.pdf
11 Berne Declaration, Commodities: Switzerland's Most Dangerous Business, op. cit.; Natural Resource Governance Institute, "Swiss disclosure proposal would promote global transparency", September 2012, http://www.resourcegovernance.org/news/press_releases/swiss-disclosure-proposal-would-promote-global-transparency
12 Berne Declaration, "A supervisory authority to combat the regulatory lacuna in the commodities sector", 2014, https://www.bernedeclaration.ch/fileadmin/files/documents/Rohstoffe/14_295_EVB_ROHMA_Paper_A4_EN_FINAL_LowRes.pdf

deals remain *de rigueur* for the major trading houses – and these deals are producing big profits.[13] The recent Panama Papers leak is a compelling reminder of the importance of corporate transparency and oversight of major financial flows related to public assets.

2016 is the right time to act. In Switzerland, the world's largest commodity trading hub, the government has committed to put a law before parliament by late 2016 that aligns with the requirements of the extractives transparency provisions in the EU Accounting and Transparency Directives. The draft law does not include commodity trading transparency— even though that is the area where Swiss reporting could make a real difference. However, the Swiss Federal Council has indicated that it will extend the scope of the legislation quickly to include payments to governments for commodity trading, but only as part of an "internationally agreed process."[14]

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UK action could, therefore, have a significant impact on Swiss decision-making. Establishing reporting requirements in the UK and Switzerland would capture over half of the world's commodity trading, significantly addressing the current transparency gap.[15] Decisions taken at the summit could also influence the US Securities and Exchange Commission (SEC), which has committed to release its final payment transparency rules under Section 1504 of the Dodd-Frank Act by the end of June 2016. The SEC rules will determine whether reporting on trading-related payments is required for companies listed on U.S. stock exchanges.[16]

Several recent developments create precedent and prove the feasibility of such reporting. The Extractive Industries Transparency Initiative (EITI) has addressed trading since 2013. In February 2016, the EITI Standard was further refined to require trading payments and now states: "Where the sale of the state's share of production or other revenues collected in-kind is material, the government, including state owned enterprises, are required to disclose the volumes sold and revenues received. The published data must be disaggregated by individual buying company and to levels commensurate with the reporting of other payments and revenue streams."[17] Both the U.S. and E. U. payment reporting regimes explicitly drew on the EITI as precedent, and they should continue to do so with respect to trading.

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Reporting by some individual companies and governments illustrates the feasibility of disclosing data on payments to governments for the sale of oil and gas. In 2015, Swiss trading giant Trafigura broke ranks with its secretive peers, and published data on $4.3 billion in payments to the governments of Colombia, Ghana, Nigeria, Norway, Peru, and Trinidad and Tobago.[18] Company officials have spoken enthusiastically about the process and its impact on Trafigura's reputation (especially with their many lenders), and described the administrative burden as reasonable. Private sector consultancies are vaunting the benefits that such reporting can bring to other traders.[19] The Kurdistan Regional Government (KRG) in Iraq recently began to publish monthly payment data on its oil sales in an attempt to reduce suspicion

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13 *Financial Times*, "Oil trading houses tweak old playbook in market rout," 5 January 2016. http://www.ft.com/intl/cms/s/0/3606d1a0-b3c0-11e5-8358-9a82b43f6b2f.html#axzz3zJEotYSO

14 Swiss Federal Council, "Federal Council determines basis for new company law", 4 December 2015, http://www.ejpd.admin.ch/ejpd/en/home/aktuell/news/2015/2015-12-04.html

15 Natural Resource Governance Institute, Berne Declaration, Swissaid and Publish What You Pay, "In pursuit of transparent trading", October 2015. http://www.resourcegovernance.org/sites/default/files/nrgi_TradingPaper.pdf, pp. 6-7.

16 The statutory language for Dodd Frank Section 1504 clearly gives the SEC discretion to include trading-related payments in its implementing rule. See https://www.sec.gov/comments/s7-25-15/s72515-38.pdf

17 2016 EITI Standard, requirement 4.2. https://eiti.org/files/english_eiti_standard_0.pdf

18 Trafigura, *2015 Responsibility Report*, http://www.trafigura.com/responsibility/2015-responsibility-report/

19 RCS Global, "7 reasons why trading companies disclosing payments to governments makes good business sense", June 2015, GOXI, http://goxi.org/profiles/blogs/7-reasons-why-trading-companies-disclosing-payments-to?xg_source=msg_mes_network

and corruption risks in a volatile region. (However, the reports withhold the names of the buyers even though they paid $557 million to the KRG authorities in March 2016 alone.[20]) The governments of Iraq and Nigeria now publish some EITI data on trading transactions, though this is generally with a significant time-lag. The 2013 Iraq EITI report included reconciled sale data on $80 billion in crude sale payments by 42 companies, including BP and Shell.[21] However, given its voluntary nature, the EITI will likely never bring transparency to the citizens of countries like Libya, Angola or Equatorial Guinea. Regulation in countries where traders are domiciled or listed is needed to deliver a more thorough, timely and standardized approach.

Leadership by the U.K. is needed. Home to an estimated 25 percent of the global physical oil trade, the U.K. is a major commodity trading hub, due in part to the large trading arms of companies like BP and Shell and the fact that other major players like Glencore and Sinopec are publicly listed in the UK.[22] From the birth of the EITI to pushing for payment disclosure as part of the EU Accounting and Transparency Directives, advancing extractive sector transparency has relied on UK leadership.

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Therefore, the **U.K. government should**:

1. **Commit to including commodity trading in its own reporting requirements, and push for this change at the EU level.** While the U.K. now requires extractive companies to report payments related to their upstream activities, these companies and other traders are not required to report on payments made to governments that arise from trading activities. It is now time for the U.K. to signal that it will address this inconsistency by ensuring that a revised version of the U.K. Reports on Payments to Governments Regulations 2014 and the broader Accounting and Transparency Directives will include trading transparency. The UK government could announce this commitment at the summit and include it in the UK's third OGP national action plan.[23]

2. **Champion this issue at the Anti-Corruption Summit.** Along with announcing its intention to include trading payments in revised UK and EU legislation, the U.K. can use this opportunity to precipitate action from other trading hubs – namely Switzerland, Singapore and the United States. While U.K. and EU action will contribute immensely to addressing the current transparency gap, broader global action would lead to greater openness and level the playing field across home country jurisdictions.

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20 Kurdistan Regional Government, Ministry of Natural Resources, *March 2016 Monthly Lifting, Export and Revenue Report*, April 2016. p. 6. http://mnr.krg.org/images/monthlyreports/EXPORTs/MNR_Monthly_Export_Report_March_2016.pdf

21 The Iraq 2013 EITI Report, published in 2015, https://eiti.org/report/iraq/2013.

22 Berne Declaration, *Commodities: Switzerland's Most Dangerous Business*, 2012, https://www.ladb.ch/fileadmin/files/documents/Rohstoffe/commodities_book_berne_declaration_lowres.pdf , p.39

23 Reviews of the UK Reports on Payments to Governments Regulations 2014 and EU Accounting Directive are set to take place in 2017 and 2018 respectively.