

In Pursuit of Transparent Trading



KEY MESSAGES

- Commodity trading companies are influential actors, and whether they follow transparent and accountable business practices matters to developing countries.
- Transparency should feature across traders' engagements with public sector institutions, including but not limited to the crucial issue of commodity sales.
- The EITI has catalyzed some progress already, and could do more by clearly requiring the disclosure of data that is broken down by individual sale.
- Due to the large number of commodity traders based in Switzerland, the Swiss government should include trading in its forthcoming extractive industry reporting regulations, and encourage governments of other major trading hubs to follow its lead.
- Companies and governments have individual responsibilities to disclose information, and can emulate emerging good practices.

1. The adoption of transparent and accountable business practices by commodity traders matters to developing countries.

Commodity trading and the activities of trading companies influence economic and governance outcomes in developing countries. Typically privately owned with flexible business models, many trading companies work extensively in “high-risk” environments – including countries with weak institutions, conflicts or other challenges that scare away more risk-averse companies. Given the size of this footprint, and its prevalence in countries with high levels of corruption or poverty (or both), the quality of trading companies' business practices is of serious concern.

Trading companies play several roles through which they influence public institutions and public revenues, and they frequently build close relationships with top officials and political elites. They are major buyers of raw materials sold by governments and state-owned companies worldwide, and these transactions generate significant public revenues. Traders also provide large loans to governments, sell refined products, and enter into joint ventures with state-owned entities. They are expanding their upstream and downstream operations in developing countries as well.

Traders therefore play a valuable role in developing countries, finding markets for raw materials or providing much-needed financing and logistical expertise. However, past experience shows that governance challenges arise when companies do not prioritize transparency and accountability. These controversies can damage the reputation of



trading companies with investors, and can create problems in host countries. For instance, in the absence of full reporting and clear regulatory guidelines, traders have faced critical questions about whether they do business with politically exposed persons. Alarms have also been raised by suspicious payments, such as commissions to government advisors paid by trading company representatives seeking new business opportunities. Often, such payments go through complicated webs of offshore companies, which make it challenging for authorities to trace the funds.

Along with helping to guard against corruption and the abuse of power by public officials, transparency can facilitate accountability in resource-rich countries. Citizens, journalists, parliamentarians and other oversight actors need access to information about their country’s public finances, including the deals that their government signs with trading companies. Transparency facilitates oversight and discourages self-dealing by public officials. From a competition perspective, it also levels the playing field, which creates a more stable business environment.

2. Transparency should address commodity sales, as well as other engagements by traders with public sector institutions.

Despite being an important contributor to government revenues in some of the world’s poorest countries, levels of transparency around commodity trading remain low. In deciding how to tackle this challenge, two questions arise: which actors should advance transparency, and what should be made transparent?

Switzerland is the logical place to begin the pursuit of transparent trading. The country is home to some of the world’s biggest trading houses for crude oil and other commodities; these include Vitol, Glencore, Trafigura, Mercuria and Gunvor. Switzerland’s market share in trading could reach between 30 and 60 percent, depending on the commodity. (See figure 1, reproduced from the *Financial Times*).

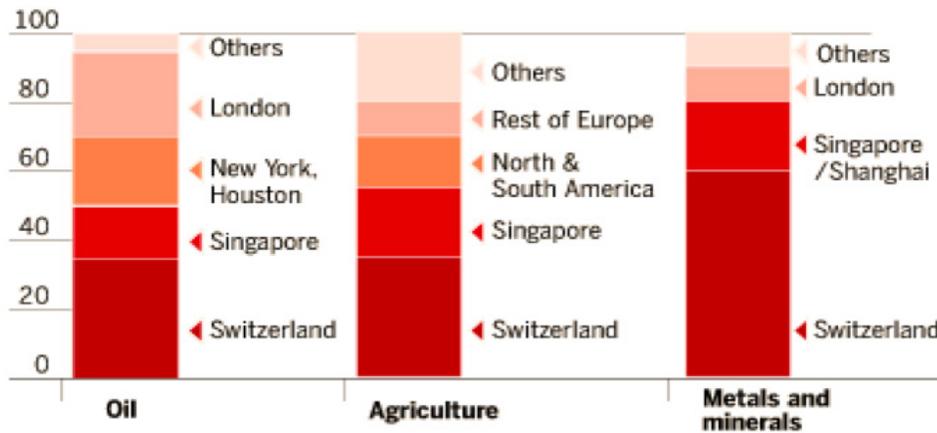


Figure 1. Market share of commodity trading, 2012 (%)¹

Non-Swiss companies also engage in trading activities that affect economic and governance outcomes in developing countries. These include integrated oil companies with trading divisions, such as Shell, BP, Petrobras, Sinopec and Repsol, as well as commodity trading companies based in other jurisdictions like the Noble Group and Mitsui, based respectively in Singapore and Japan.

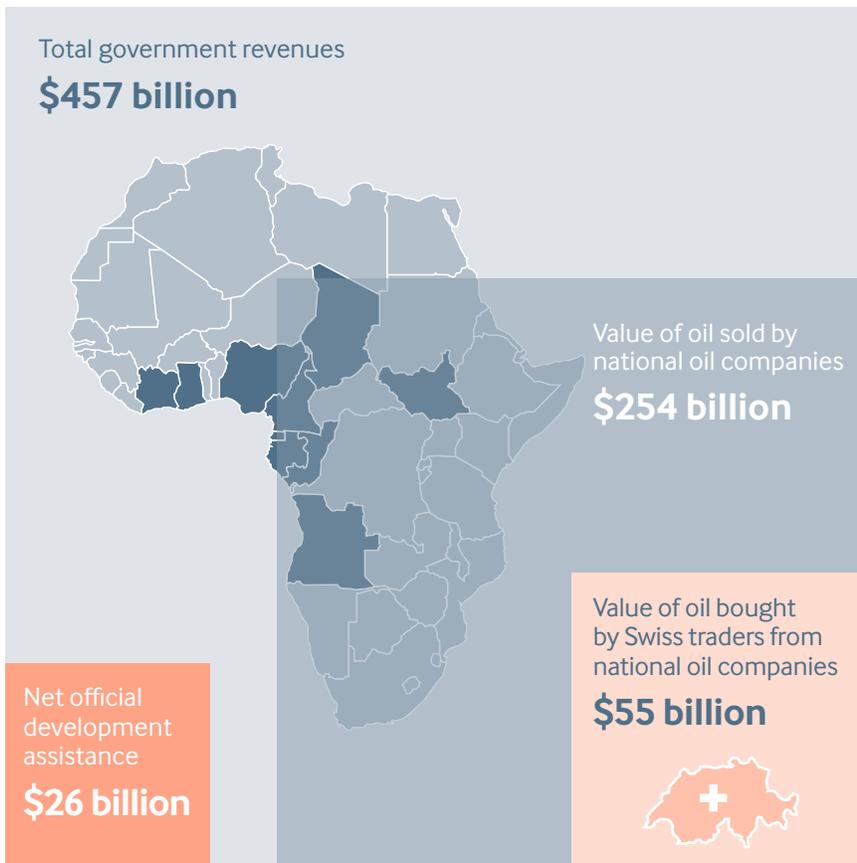
¹ *Financial Times*, “Swiss ties to trading houses under strain,” 26 March 2013.

It is most important to achieve transparency in transactions that directly affect public resources and public revenues. Along these lines, transparency should begin with the business conducted with governments and state-owned companies because these affairs impact public revenues and can affect the integrity of public office holders.

One of the foremost types of such transactions is the sale of raw materials by government entities to commodity traders. While still conducted largely in secret, these transactions have rightly received the most attention in discussions about transparent trading to date. Many oil-producing governments in particular sell the share of production they have received through in-kind payments, a production-sharing contract, equity participation, or their own production. As shown in our 2014 study *Big Spenders*, such oil sales are too large to ignore: from 2011 to 2013, the total value of oil sales by national oil companies in sub-Saharan Africa’s top ten oil producers equaled \$254 billion—the equivalent of 56 percent of combined government revenues for these countries.²

A huge share of those payments – \$55 billion – was made by commodity traders based in Switzerland. (See figure 2.) This is twice the total amount of global development aid for the ten countries under review, and 28 times the Swiss government’s development aid to the entire African continent. In countries such as Nigeria or Equatorial Guinea, some 20 to 30 percent of all state revenues have depended on Swiss commodity companies.

Figure 2. Oil payments by Swiss traders to sub-Saharan Africa’s top-ten oil exporting countries, 2011-2013³



2 Berne Declaration, NRGi, SWISSAID, *Big Spenders: Swiss Trading Companies, African Oil and the Risks of Opacity*, July 2014.
 3 *Ibid.* The countries are Angola, Cameroon, Chad, Côte d’Ivoire, Republic of Congo, Equatorial Guinea, Gabon, Ghana, Nigeria and South Sudan.

Transparency in commodity sales should be thorough and detailed enough to enable citizens to examine the fairness and integrity of deals. **Sale-by-sale data is essential for transparency.** Companies and private sector analysts already collect data on each sale, such as in cargo-by cargo lifting schedules which circulate commonly in industry circles. To be useful, the transparency of commodity sales would include the following reporting *on each sale*:

- The name, beneficial owner and country of incorporation of the buying company, and a description of how the buyer was chosen
- The sale date, the grade of the commodity sold, the volume, the price and information about how the price was determined, and the amount of the payment made
- Information on non-monetary sales, i.e., when commodities are exchanged for other assets such as petroleum products or infrastructure, or used to repay loans.⁴

Transparency in commodity sales is the right place to start, and the wrong place to stop. Trading companies engage in other kinds of business that affect public revenues, influence public sector governance, and generate corruption risks—and therefore these transactions also warrant transparency. They include the following:

- *Lending by commodity traders.* Even if the media learn the amount of a loan, the terms and costs of this borrowing are rarely revealed. For example, Trafigura lent Ghana's national oil company \$700 million in 2014, though reduced the amount owed to \$350-400 million after the oil price crash;⁵ Glencore lent the government of Chad \$1.4 billion in 2013.⁶
- *Joint ventures with state-owned companies, or with companies whose beneficial owners include politically exposed persons.* For example, Trafigura has a number of business partnerships with entities affiliated with Angola's national oil company, and with current and former government officials.⁷
- *Upstream exploration and production activities that can lead to government payments* (taxes, royalties, etc.). Mercuria owns shares in companies with upstream business in the US, Canada, Argentina, Nigeria and Equatorial Guinea. Glencore runs mining operations worldwide and owns oil assets in Chad and Equatorial Guinea.
- *Downstream activities that impact public revenues,* such as the sale of petroleum products to state-owned entities. A number of Swiss traders sell gasoline and kerosene to the Nigerian government, for example.

To achieve transparent trading, reporting would be needed in these areas which impact public revenues and state institutions.

4 For instance, in the 2011-2014 period, Nigeria's national oil company channeled \$35 billion worth of oil into mismanaged crude oil-for-petroleum product "swap" deals. In the absence of transparency, unbalanced contract terms led Nigeria to lose over \$16 per barrel in public revenues. Natural Resource Governance Institute, *Inside NNPC Oil Sales: A Case for Reform*, August 2015.

5 *Reuters*, "Ghana oil firm GNPC to cut Trafigura loan due to crude price dip," 7 April 2015.

6 *Bloomberg Business*, "Chad to Reschedule \$1.5 Billion of Glencore-Led Oil Loans," 10 May 2015.

7 Berne Declaration, "Trafigura's Business in Angola," February 2013.

3. The EITI can catalyze progress by requiring the disclosure of data that is broken down by individual sale.

The Extractive Industries Transparency Initiative (EITI) has triggered new reporting on commodity trading, and should take steps to strengthen this catalytic role. The EITI revised its reporting rules in 2013, and the resulting EITI Standard includes requirement 4.1.c on commodity sales, reproduced below. This provision has triggered initial implementation efforts by different EITI implementing countries, such as Nigeria, Iraq and the Republic of Congo, as well as broader conversations among stakeholders about how to improve the transparency of commodity trading.⁸

Section 4.1(c) of the EITI Standard

Sale of the state’s share of production or other revenues collected in-kind

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 to levels commensurate with the reporting of other payments and revenue streams (Requirement 5.2.e). Reporting could also break down disclosures by the type of product, price, market, and sale volume. Where practically feasible, the multi-stakeholder group is encouraged to task the Independent Administrator with reconciling the volumes sold and revenues received by including the buying companies in the reporting process.

To generate more useful reporting, the EITI should explicitly require commodity sale reporting on a per sale basis. Commodity prices vary wildly during a given year, and sales do not typically occur on a regular schedule. Aggregate data, therefore, obscures the deal in question and has far less value to potential users. This kind of granularity is not without precedent. Oil market data worldwide is organized by sale, and for each sale, the parties to the transaction record information including the volume, the grade of crude sold, the ship, the date and the price. While not formally disclosed, this kind of sale data is circulated among industry players. Governments do sometimes disclose data on this level. The data in figure 3, drawn from a Ghanaian government report, shows the highly material nature of individual sales – each one generated at least \$79 million in public revenues – and that the per sale revenues varied by as much as \$24 million in a given year due to price fluctuations.

PERIOD	DATE OF LIFTING	VOLUME OF LIFTING	SELLING PRICE	VALUE OF LIFT	
	dd/mm/yy		US\$	US\$	GH ₵
1st Quarter	20- Dec-13	917,189	110.965	101,775,877.39	244,155,241.06
	29-Jan-14	947,220	108.975	103,223,299.50	259,585,953.58
2nd Quarter	25-Mar-14	947,276	107.591	101,918,372.12	283,526,719.40
	13-May-14	947,574	109.25	103,522,459.50	311,571,546.36
3rd Quarter	17-Jul-14	987,415	105.769	104,437,897.14	316,833,248.55
4th Quarter	02-Sep-14	995,230	98.057	97,589,268.11	312,041,684.78
	10-Oct-14	948,894	83.807	79,523,959.46	254,381,241.52
TOTAL		6,690,798		691,991,133.22³	1,982,095,635.25

Figure 3. Sale-by-sale reporting of the government of Ghana’s oil sales, 2014, highlighting changes in price per sale⁹

8 For more on implementing country reporting, see: EITI, “The EITI, NOCs and the First Trade,” March 2015.

9 Public Interest and Accountability Commission, “Report on Management of Petroleum Revenues for Year 2014.”

We therefore strongly recommend that the EITI clarify the current language of provision 4.1.c to more clearly require the disclosure of individual sale data. A sale is the equivalent unit to the project-level reporting that is required for other types of payments, as detailed in provision 5.2.e of the EITI Standard.

In addition to this urgent change, the good practices embedded elsewhere in the EITI Standard should also apply to commodity sales. At its core, the EITI Standard requires a **reconciliation** of the payments made by companies and revenues received by government entities. The Standard does not require the same check on commodity sales, even though the payments received in exchange for raw materials can dwarf other revenue streams. Through the 2013 Standard, the EITI transparency framework now requires or encourages reporting on the process for **allocating licenses**, the **beneficial owners** of license holders, and the **contracts** related to the exploitation of oil, gas and minerals. As evidenced by corruption and abuse in numerous countries, this information is no less relevant in the area of commodity trading. We therefore strongly encourage the extension of the provisions relating to reconciliation, license allocations, beneficial ownership and contract disclosure to include commodity trading.

4. The Swiss government should include trading in its forthcoming extractive industry reporting regulations, and encourage governments of other major trading hubs to follow its lead.

The EITI has deficiencies, such as the non-participation of some opaque governments, a two-year time lapse in its reports, and reporting that is frequently even later than that. Hence the EITI framework has been complemented by a growing number of home-country regulations that mandate the disclosure of payments to governments by all extractive industry companies registered in the respective country and/or listed on its stock exchanges. So far, such laws have been passed in the EU, Canada, Norway and the US. Some 75 to 80 percent of listed extractive companies are now covered by these regulations. However, these important regulations do not thus far cover payments stemming from commodity trading activities, such as the commodity sale transactions covered by the EITI's provision 4.1.c. The government of Switzerland could close this gap if it accept its responsibility as the world's leading commodity trading hub and enacts a payment disclosure law that covers commodity trading.

The Swiss government has committed to passing extractive sector payment disclosure regulations. The proposed provisions are found within the preliminary draft of a broader initiative to revise the Swiss company law ("Aktienrechts-Revision"),¹⁰ have already been through a public consultation,¹¹ and are currently under review by the government. The provisions are largely aligned with the payment disclosure requirements in the EU Accounting and Transparency Directives. It is estimated that the government will send the second draft to Parliament by mid-November 2015.

10 For background, see: <https://www.bj.admin.ch/bj/en/home/wirtschaft/gesetzgebung/aktienrechtsrevision14.html>.

11 Joint Swiss NGO submission: https://www.ladb.ch/fileadmin/files/documents/CSR/DB_Prise-de-position_Revision-droit-societes_fevrier2015.pdf; NNGI and PWYP submission: <https://www.bj.admin.ch/dam/data/bj/wirtschaft/gesetzgebung/aktienrechtsrevision14/stgn-weitere-tn-2.pdf>.

The current draft language signals that Switzerland may miss a critical opportunity to substantially improve natural resource transparency. The draft language refers only to payments made to governments stemming from exploration and production, but leaves out trading, even though trading companies dominate the Swiss commodities sector. The draft law does suggest that commodity trading payments could be considered at a later stage, but only if other jurisdictions do the same:

Article 964f of the draft revisions to the Swiss company law

Expansion of scope¹²

The Federal Council is entitled to decree, in line with an internationally coordinated process, that commodity trading entities are equally subjected to all obligations of articles 964a-964e.

We strongly urge the government of Switzerland to subject trading companies to all obligations contained in articles 964a-964e of the pending revision of the Swiss company law. If the Swiss regulations leave out trading, their actual impact on improving transparency globally will be limited. A number of the large Swiss companies that engage in upstream exploration and production of petroleum and minerals, such as Vitol and Glencore, are already covered by the EU legislation – for example, Vitol due to its holding company registered in the Netherlands and Glencore due to its listing on the London Stock Exchange. Requiring disaggregated trading payments would ensure that the regulations reflect the Swiss context, are fit for purpose, and help facilitate greater accountability in host and home countries.

As a minimum but immediate step, the Swiss government should follow through on its stated intention to initiate international action on trading transparency. In the explanatory report accompanying the Swiss draft law, the Federal Council states that an “internationally coordinated process” might lead to a situation where “several internationally important commodities trading hubs are also applying transparency provisions to commodity trading entities.”¹³ The obligation to reach out and form such a “first mover’s group” of key trading hubs falls to the biggest player, Switzerland. In its report on natural resource transparency published in June 2014, the Federal Council mentions the possibility of Switzerland initiating a multilateral initiative to advance transparency provisions for the commodity trading sector.¹⁴ This idea has been taken up in a policy paper published by the European Centre for Development Policy Management: “A pragmatic approach would therefore seem to be to form a small group of like-minded, pioneering countries and to move forward in a coordinated manner, towards a levelled playing field.”¹⁵

Already, in the UK, civil society groups have begun to engage with government to advocate for a commitment to commodity trading transparency as part of the UK’s upcoming Open Government Partnership National Action Plan (NAP) 2016-2018.¹⁶ Taken together, action in the UK and Switzerland would already capture over half of the world’s commodity trading and significantly improve transparency in the trading of oil, gas and minerals.

12 This is the author’s own translation from the German text of the draft law and does not represent official language. The official proposal in French can be accessed here: <https://www.bj.admin.ch/dam/data/bj/wirtschaft/gesetzgebung/aktienrechtsrevision14/vorentw-f.pdf>.

13 <https://www.bj.admin.ch/dam/data/bj/wirtschaft/gesetzgebung/aktienrechtsrevision14/vn-ber-f.pdf>

14 <http://www.ejpd.admin.ch/dam/data/bj/aktuell/news/2014/2014-06-25/ber-f.pdf>

15 <http://ecdpm.org/wp-content/uploads/BN68-commodities-extractive-sector-september-2014.pdf>

16 See the Open Government Manifesto produced by the UK Open Government Network. Section 2 calls on the UK government to “work for EU-wide extractives commodity and other payments disclosure”. <http://www.opengovernment.org.uk/engage/open-government-manifesto/>

5. Companies and governments have individual responsibilities to disclose information.

A number of governments and companies have shown that it's not necessary to wait for global standards or binding regulation to adopt transparent practices. And through their actions, a set of good practices are emerging which can be emulated by their peers.

Outside of commodity trading specifically, several examples illustrate the positive effects of leadership from individual actors. Governments in Guinea, Afghanistan and many others chose to disclose all mining contracts. The UK government has decided to publish a registry of the beneficial owners of UK companies. The national oil company in Nigeria, eager to demonstrate a new commitment to transparency, recently disclosed financial data on its subsidiaries for the first time. On the private sector side, companies including Rio Tinto, BHP Billiton, Statoil, Kosmos and Tullow have all chosen to voluntarily issue public reports with detailed payment data that either extend beyond or preceded legal requirements.

With respect to trading, similar commitments are starting to emerge. Governments in countries including Ghana, Yemen and Nigeria provide some cargo-by-cargo oil sale data. Trafigura, one of the world's largest trading companies, has indicated its intention to publish data about its purchases of oil from governments and state-owned companies.¹⁷ The initial reporting by Trafigura is expected before the end of 2015, and should help to demonstrate the viability and usefulness of these reporting practices.

Surveying the past five years, there emerges a clear trend towards more transparent trading. We encourage home- and host-country governments (including and especially that of Switzerland), companies who conduct trading activities, and the EITI itself to consider how they can strengthen their leadership role in the years to come.

17 <http://www.trafigura.com/responsibility/transparency/>