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SWISSAID

Frequently asked questions on the transparency of payments in the commodities sector and Switzerland's role

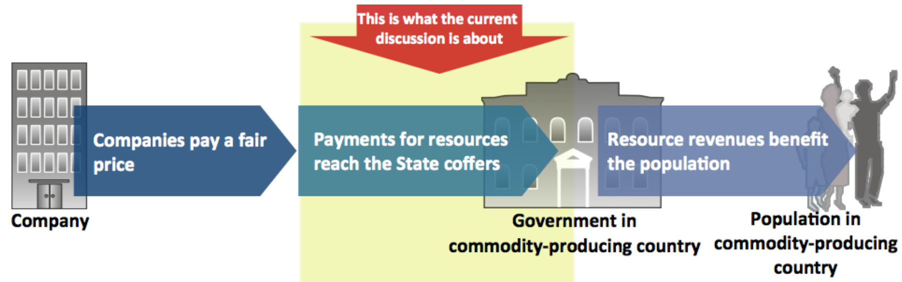
What is the problem?

Two-thirds all of mineral and energy resources come from developing countries. These riches represent enormous development potential. If these riches could properly benefit the people of these countries, extreme poverty could be almost halved by 2030.[1] Despite being commodity-rich, a large number of countries remain stuck in what is known as the "*resource curse*" – the paradox that countries and regions with an abundance of minerals and hydrocarbons tend to have more corruption, longer conflicts, and worse development outcomes than countries with fewer natural resources.

What effect could transparency have?

There are various forms of transparency. The instrument under discussion here, the "Disclosure of Payments", means that payment flows between commodity companies and commodity-producing countries (but not between private parties) must be published. This increases the pressure for commodity revenues really to reach the State coffers (Fig. 1 point 2). Disclosure of payments is a far stretch from being the complete solution to solve the resource curse problem. But it is a precondition to the improvement of the situation. Only the publication of the public revenues reaped from commodities would enable local civil society (where necessary with international support) to be able to put critical questions to their governments, and to hold those governments to account for the redistributions of the rents (point 3) derived from commodities. Transparency can therefore be of assistance in establishing conditions for autonomous development. It is also an excellent means of creating a relationship of confidence between citizens and their governments, and of preventing the embezzlement of public assets. This is why Publish What You Pay (PWYP), a network of over 800 civil society organizations, is campaigning globally for greater transparency in the natural resources business.

Fig. 1: 3 conditions to enable the population can profit from the resource wealth – and how transparency can help



	1	2	3
Transparency Instrument	Contract transparency	**Disclosure of payments**	Transparency of expenditure
Comment	The least developed: A few **Host States** of commodity companies (= commodity-producing countries) are progressing	Very developed: 44 **Host States** advancing (EITI), important **Home States** of commodity companies have been additionally active (EU, USA etc.). But: there is an existing trapsnarency gap in **commodity trading.**	Depending on the country, a little to very developed: Parliaments, media, local NGOs and the international community hold governments accountable in commodity-producing countries.

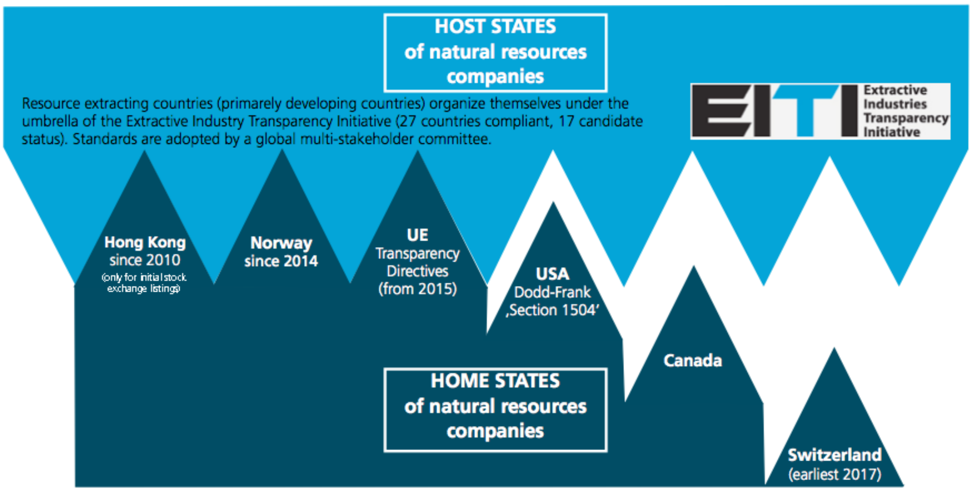
[1] McKinsey Global Institute, Reverse the curse, S. 31–33.

What measures are being taken at the international level?

In the last few years, the international community, through the creation of several instruments, has been working towards a global standard of transparency that sets out specific complimentary responsibilities for Host States (i.e. states in which commodities are found) and Home States (i.e. states where companies active in the commodity sector are headquartered)) (Fig. 2):

- Host **States:** The Extractive Industry Transparency Initiative (EITI) brings together commodity-producing states willing to work towards greater transparency. A multi-stakeholder committee (states, companies and NGOs) defines the rules at the international level (the type of payments to be made public, the level of detail etc.). The EITI members are countries (and not companies[2]), which undertake two commitments[3]: (1) to publish payments made to them by commodity companies; and (2) to require companies working in their countries also to publish these payments. Publication of these two figures therefore makes it possible to compare data and to spot any divergences and any cases of suspected embezzlements. Given that Switzerland is not a commodity producing country, it cannot become a member of EITI. Nevertheless, it is an "EITI Supporting Country" – as such it makes financial contributions. The EITI is an important initiative, but alone it is not enough. In reality, particularly opaque states (e.g. Angola) simply refuse to become EITI members. Weak states also lack the ability to exercise control. Apart from the exclusion of a member state from participating in the initiative, EITI has no means of enforcing its provisions.

Fig. 2: Interlinked global system for disclosure of payments (payments by commodity companies to governments)



- **Home States**: as a result of the above, more and more states where commodity companies are headquartered are contributing to enhancing transparency as a means to combat the gaps in the EITI, with the EU and USA having taken the lead. As home to a large number of mining companies, the USA requires such companies to publish their payments to governments, regardless of whether or not these are made to EITI member states. As a result, all countries in which a company operates are identified. Data is collected to a uniform, and therefore comparable, standard, closely matched to the EITI[4]. Great Britain

[2] Companies can become "supporting companies", although this does not give them any additional publication requirements. In EITI countries, companies must disclose their payments (like every other company), but not in non-member states. The EITI is therefore not a "voluntary initiative on the part of the companies", but an initiative taken up by states in which companies and NGOs participate.

[3] Article 11, EITI Requirements: "The government is required to ensure that al relevant companies and government entities report."

[4] EU Transparency Directive: "The report should include types of payments **comparable to** those disclosed under the Extractive Industries Transparency Initiative (**EITI**). ". USA Dodd-Frank, Section 1504: "(C) the term 'payment'— (...) includes taxes, royalties, fees (including license fees), production entitlements, bonuses, and other material benefits, that the Commission, **consistent with the guidelines of the Extractive Industries Transparency Initiative** (to the extent practicable), determines are part of the commonly recognized revenue stream for the commercial development of oil, natural gas, or minerals;"

and [France](#) plan to transpose the EU directive by 1.1.2015, before the implementation period ends in July 2015. Italy, Germany, Sweden, Denmark and Finland have also announced swift national implementation plans. [Norway](#) already brought its law into force in January 2014. In the [USA](#) implementation provisions are expected by March 2015. And [Canada](#) has announced a law due in June 2015.

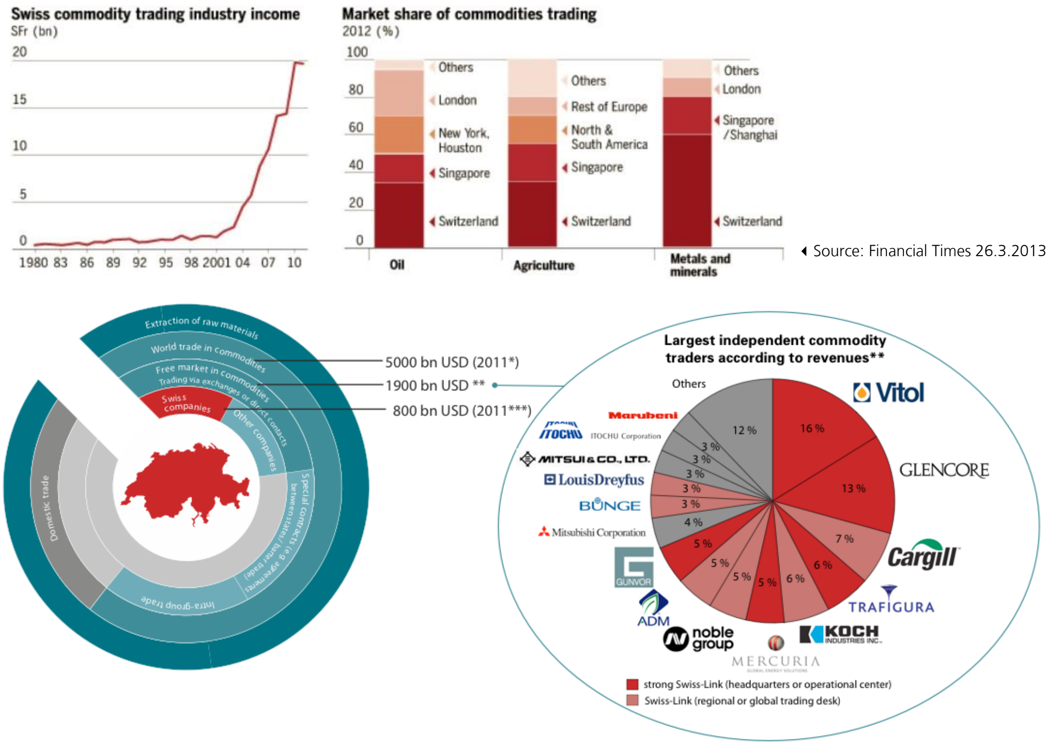
Which deficiencies persist?

- With regards to the extraction of raw materials, some [75-80%](#) of listed companies are covered by regulation from the EU, USA and other countries.
- With regards to commodity trading however, massive gaps in transparency remain. Those Guest States that have signed up to the EITI have identified and closed them. The EITI standard, revised in 2013, requires the publication of state sales of commodities to commodity traders.[5] [Iraq](#) already requires this. Since traders – in contrast to companies active in the extraction of raw materials – do not necessarily have branches present in EITI countries, their inclusion by Host States is particularly difficult. All the more reason why additional publication requirements in the Home States of commodity traders are so important.

What role does Switzerland play in commodity trading?

The Swiss commodity sector principally comprises commodity *trading*, although the majority of trading companies also carry out a part of their activities in the *extractive* domain. According to a study by the *Financial Times*, the profits made by these commodity trading companies in the last decade surpass that of the five largest automobile companies[6]. Switzerland holds the leading position at the international level in terms of commodity traders, as is highlighted by the latest data (see Fig. 3).

Fig. 3: Growth and Market Share of the Swiss Commodity Hub



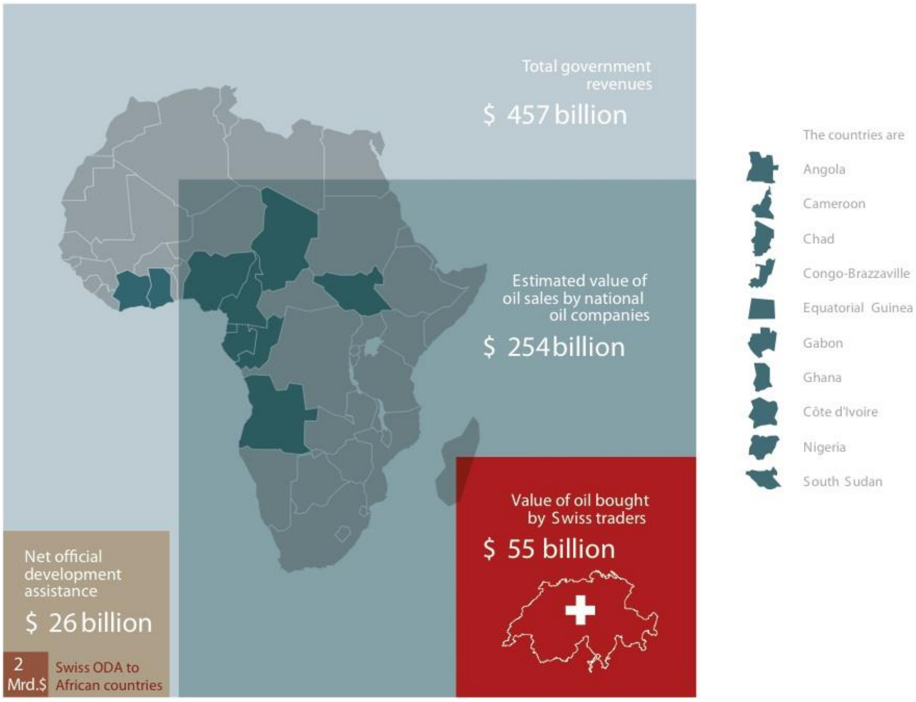
Sources: * Estimates based on UNCTAD STATS; ** Presentation by First Reserve (one of the world's largest commodity investors) at the FT Global Commodities Summit 2013 based on company data (most recent available year, figures are slightly exaggerated because turnovers in some cases include extractive activities); Swiss-Link: Research by the Berne Declaration. *** Swiss National Bank SNB Balance of Payments 2012, figures are slightly understated because the data on merchanting does not include all trading activities (e.g. where a commodity is processed between selling and buying, such as when oil is refined).

[5] Rule 4.1.c 'Sale of the state's share of production or other revenues collected in-kind'
[6] Financial Times, 15.4.13, *Traders reap $250bn harvest from boom in commodities*

How relevant are the payment flows from Swiss commodity trading?

In July 2014 BD, Swissaid and the Natural Resource Governance Institute (NRGI) presented a pioneering study, which quantified for the first time commodity payment flows between Switzerland and other countries. In cooperation with consultants from the commodity sector, 1,500 oil-trading transactions, often barely accessible to the public, were researched and analyzed. The payments made by Swiss commodity traders to governments are enormous. For the ten largest African oil countries south of the Sahara alone this amounted to at least USD 55 billion in the past three years. That is twice the total amount of global development aid for these countries and 28-times the Swiss government's public expenditure on development aid to the entire continent. In countries such as Nigeria or Equatorial Guinea some 20-30% of all state revenues depend on Swiss commodity companies. The disclosure of payments would be an efficient way of impeding the embezzlement of this income in commodity-rich countries.

Fig. 4: Relevance of the payments of Swiss trading companies for the 10 largest African oil countries 2011-2013



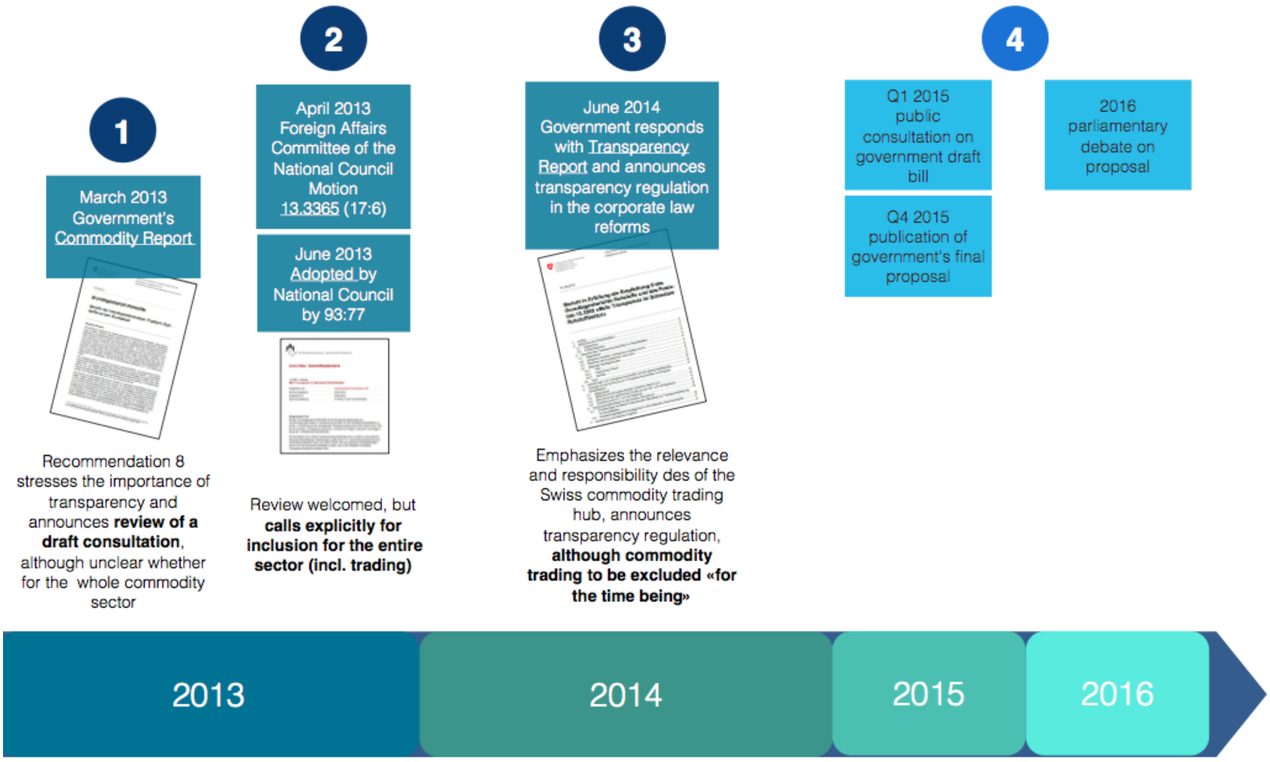
Source: For global ODA data: World Bank for 2011 and 2012 (2014 World Development Indicators), projected 3-year total; for Switzerland's development cooperation: Government statement (Response to parliamentary question 14.3595) for 2013 (entire continent) converted to 3 years; for government revenues:, IMF (2014 World Economic Outlook); for NOC oil sale and Swiss oil trading data, author calculations: see EvB/NRGI/Swissaid, 2014, Big Spenders: Swiss trading companies, African oil and the risks of opacity.

What has been happening at the political level in Switzerland until now?

In autumn 2012, the widely supported motion (French only) "Transparency of payments made by commodities companies" was placed before the National Council. In its response on the 10.11.12, the Federal Council "welcome[d] the objective of the motion to increase transparency" but nevertheless expressed its preference to wait and see how other countries intend to handle transparency and rejected the motion. The National Council dismissed the motion with 106 to 83 votes. End of March 2013 the Swiss government published the "Background Report: Commodities" as a reaction to the vigorous public debate since 2011. In recommendation 8 the report went a little bit further: "The consequences of a potential introduction of transparency requirements – similar to those of the USA and the EU – for the Swiss commodity sector should be examined – and the drafting of a consultation draft should be considered". Whether the scope would include commodity trading, however, remained unclear.

As a result, on 29 April 2013, the Foreign Affairs Committee of the National Council voted with 17 to 6 in favour of a motion which required the Federal Council to examine a draft transparency law including the whole Swiss commodity sector (both listed and non-listed companies, extractive and trading activities) and to examine how Switzerland could support a global transparency standard. Parliament passed this motion on 11 June 2013 with 93 to 77 votes. The government replied on 25 June, by publishing its Transparency Report (French only) accompanied by a comparative law report on transparency legislation in the US, EU, Canada and Hong Kong (partly in English) and announced a proposal for consultation in the coming months.

Fig. 4: Political processes in Switzerland to date and outlook



What positive points were included in the government's Transparency Report?

- **The report clearly and explicitly referred to the problem of the resource curse**: "Commodities are often mined in countries that have poorly functioning state structures. Against this background, through the extraction, or rather trading of commodities, *there is regularly a risk that the payments made to the respective governments (...) seep away* or are misused in financing conflict. Consequently, the population benefits little from the commodity riches of their country and remains in poverty, which is referred to as the so-called "resource curse"."
- **And it highlights the importance of transparency as a part of the solution:** Because information about payment and commodity flows is generally not publicly accessible, it is difficult to impossible for both civil society and political supervisory bodies, such as parliaments, to hold governments in developing and emerging countries to account for abuses. It is against this background that *requests for transparency become a central demand*."
- **The report adequately analyzes the international dynamic**: "Internationally, a trend can be observed towards increased transparency in respect of payments to governments by companies in the extractive sector. (...) These international efforts for

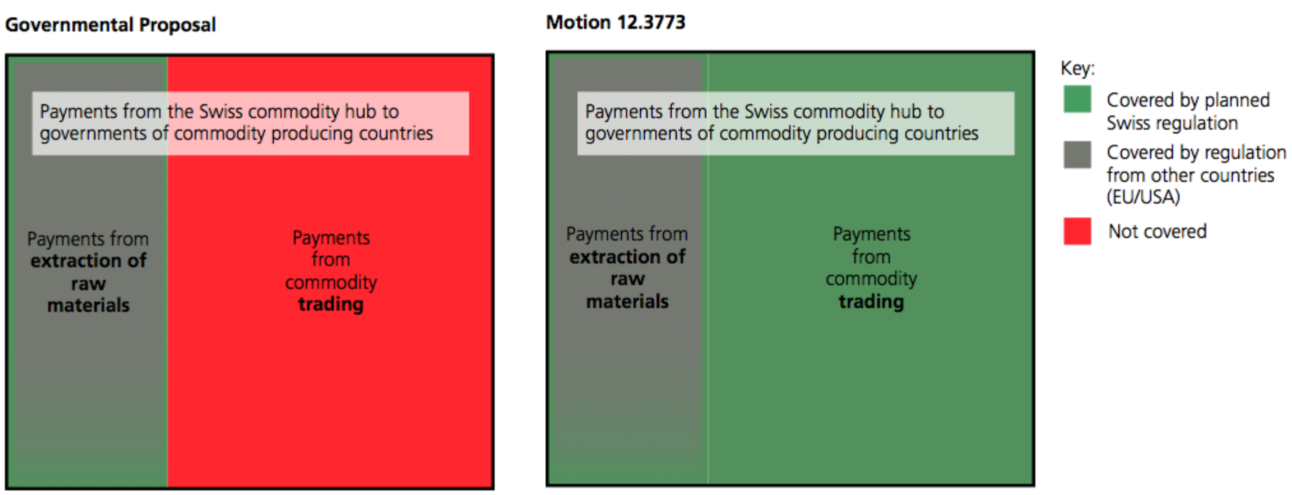
more openness in the commodities business *are not without impact on Switzerland*, since the activities of the EITI, the EU directives and the amendments to the Dodd-Frank Act in the United States also radiate to other countries and institutions."

- The government recognizes Switzerland's particular responsibility and the benefits of regulation: "*As a leading international commodity trading hub, Switzerland has a special responsibility* to support the international effort to increase transparency". Especially since "a significant proportion of the global commodity trade is undertaken from Switzerland, *transparency provisions in the field of commodity trading would reduce the reputational risks also in this area*."
- **The government consequentially identifies a need for action**: Without taking measures, Switzerland would "hardly do justice (...) to its responsibility as a significant country of domicile for commodity companies ".

Why is the government's proposal therefore entirely unsatisfactory?

- As stated above, the government stressed in its transparency report the importance of more transparency and Switzerland's "special responsibility" in commodity trading. **Yet it finally takes the amazing decision to exclude - "for the meantime" - all commodity trading from the announced transparency regulation.**
- The remaining scope of such regulation would be limited to the extraction of raw materials. But this will largely be without impact on the ground because, one assumes, the EU regulation will cover the vast majority of Swiss extraction payments (over 100,000 Euros) (see the analysis in Appendix), and thus the benefit to the people in commodity-producing countries would be minimal.

Fig. 5 Government approach sets the wrong priorities and achieves little transparency



In order to fulfil its responsibility, each country must start where it can most effectively achieve transparency. Countless Host countries and the most important Home countries of extraction companies have done this. Should Switzerland as leading commodity trading hub exclude this branch from transparency regulation, the law would be a „red herring", without any credibility. The fact that the government stops short of including trading yet requests from Parliament the competence to include it in the regulation should it need to react quickly in the event other countries include it, shows that the government recognizes the need for action, but is simply not brave enough to act.

Appendix

How far do the US and European transparency rules catch Swiss commodity companies?

The Swiss commodity sector is extremely concentrated. A small group of companies effectively shares a major part of the market. **The payments of this group in terms of the *extraction* of commodities (rather than the *trading* of commodities[7]) are covered by the US regulations and most certainly by the European ones**, as shown by the table below (US criteria: listing on US stock exchange; EU criteria: listing on an EU stock exchange or large EU registered parent company[8]).

<table>
<tr><th>Company</th><th>Relation to Switzerland</th><th>Covered by…</th><th>Because…</th><th>Covered by US/EU are payments to governments made in relation to…</th></tr>
<tr><td>Vitol</td><td>Main sales department in Geneva (Vitol S. A., Vitol Holding S.à.r.l)</td><td>EU AD</td><td>Vitol Holding BV (parent company) registered in the Netherlands. Only 3 employees in 2012.</td><td rowspan="5">Extraction activities (but not payments made in relation to trading activities)</td></tr>
<tr><td>Glencore</td><td>Principal headquarters in Baar (Glencore plc, St. Helier, Baar Branch)</td><td>EU TD</td><td>Listing on London stock exchange (LSE)</td></tr>
<tr><td>Trafigura</td><td>Major branches (principal sales and administrative departments) in Geneva and Lucerne</td><td>EU AD</td><td>Trafigura Beheer B.V. (parent company) registered in the Netherlands. ≥ 34 employees in 2012.</td></tr>
<tr><td>Mercuria</td><td>Principal administrative and sales departments in Geneva</td><td>EU AD</td><td>Mercuria Energy Group Ltd (parent company) registered in Cyprus.</td></tr>
<tr><td>Gunvor</td><td>Branch (principal sales department for LNG and natural gas) and subsidiary (principal sales department for petrol and coal) in Geneva</td><td>EU AD</td><td>Gunvor Group Ltd. (parent company) registered in Cyprus.</td></tr>
<tr><td>Vale</td><td>Important branch in Saint-Prex (VD)</td><td>DF 1504</td><td>Listed on a US stock exchange (NYSE)</td><td>Extraction and export activities</td></tr>
<tr><td>Soft commodity traders: Cargill, Louis Dreyfus, Bunge, ADM</td><td colspan="4">These companies are principally traders and producers of agricultural commodities. The US and EU regulations only relate to non-renewable commodities such as petrol. The extractive activities of the ABCD group are limited, which is why only a few of their activities are subject to the US and EU norms.</td></tr>
<tr><td>Oilfield service companies: Schlumberger, Baker Hughes, Transocean</td><td>Listed on the Swiss stock exchange</td><td>DF 1504</td><td>Listed on a US stock exchange (NYSE)</td><td>Extraction and export activities</td></tr>
</table>

[7] The EU regulations do not include trading activities. The US rules [due to a court judgement currently under review at the SEC] do to a certain extent (processing, export), but they do not affect Swiss commodity traders since they typically have no listing on a US stock exchange.
[8] EU Accounting Directive (EU AD), Article 42(1): "Member States shall require **large undertaking and all public interest entities** active in the extractive industry or the logging of primary forests to prepare and make public a report on payments made to governments [...]"; Article 3(7): "**Large groups** shall be groups (...) which, on a consolidated basis, exceed the limits of **at least two of the three** following criteria (...): (a) balance sheet total: EUR 20 000 000; (b) net turnover: EUR 40 000 000; (c) average number of employees during the financial year: 250"; Article 44 (1): "A parent undertaking is considered to be active in the extractive industry or the logging of primary forests **if any of its subsidiary undertakings are active** in the extractive industry or the logging of primary forests." The EU Transparency Directive (EU TD) extends those requirements to companies listed on EU regulated stock markets even if they are not registered in the EU/EEA and are incorporated in other countries.