POLICY DIALOGUE ON NATURAL RESOURCE-BASED DEVELOPMENT

THEMATIC DIALOGUE ON COMMODITY TRADING TRANSPARENCY

Corruption Risks in the Commodity Trading Value Chain

(For discussion)

This document was prepared by the OECD Development Centre and is submitted for discussion under Part 2 of the Thematic Dialogue on Commodity Trading Transparency at the Fifteenth Plenary Meeting of the Policy Dialogue on Natural Resource-Based Development (30 November - 4 December 2020).

Participants in the Thematic Dialogue on Commodity Trading Transparency are invited to provide written comments on this discussion paper by 20 December 2020 by emailing the Secretariat (lahra.liberti@oecd.org and elliot.smith@oecd.org).

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1. Introduction

1. The effect of corruption in commodity trading can be significant for developing countries due to the scale of revenues derived from the sales of publicly-owned commodities. Recent research by the Natural Resource Governance Institute (NRGI) in respect of oil & gas sales from national oil companies (NOCs) to commodity traders and other buyers, showed that sales from 35 NOCs generated over USD 1.5 trillion in 2016, which equalled 22 per cent of those countries' total government revenues (NRGI, 2019[1]). Many developing countries are heavily dependent on revenues from the sale of publicly-owned commodities. For example, revenue from the sales of publicly-owned oil & gas account for more than two thirds of total government revenues in Azerbaijan, Iraq, Nigeria and the Republic of Congo, (UNCTAD, 2020[2]) and more than half of total government revenues in Libya (Sayne and Gillies, 2016[3]).

2. Commodity trading presents specific and heightened risks of corruption due to the large amount of money involved in commodity sales transactions. The magnitude of the amounts of money involved in commodity trading transactions constitutes a risk factor in itself as the amounts are such that even minor embezzlement, may divert substantial amounts of resources in terms of absolute value (Longchamp and Perrot, 2017[6]). The sophisticated mechanisms often used to channel corrupt payments add to this risk. These can include complex and opaque corporate structures, including off-shore entities, that render the identification of beneficial owners more difficult, kick-back schemes, use of intermediaries (including briefcase or shell companies) and joint ventures with politically exposed persons (PEPs), through which rents can be diverted through legitimate means (such as cashing dividends on behalf of PEPs).

3. Opportunities for corruption may be increased in jurisdictions with poor governance and accountability measures or where transactions are not covered by international regulatory frameworks. For example, an analysis of oil sales by NOCs on a total revenue basis, demonstrates that 79 per cent, or USD 1.21 trillion, of these oil sales occur in countries that are termed "weak" or "poor" in the 2017 Resource Governance Index.

4. In 2016, the OECD Development Centre published the report on *Corruption in the Extractive Value Chain: Typology of Risks, Mitigation Measures and Incentives*, presenting the first evidence-based analysis of patterns of corruption at each segment of the value chain, taking a multi-dimensional approach in order to address both the supply and demand sides. The Corruption Typology identified a number of corruption risks in commodity trading and recommended measures for host governments, home governments, and commodity trading companies to mitigate these risks (OECD, 2016[5]).

5. The involvement of state-owned enterprises (SOEs) in commodity trading transactions can result in a heightened risk of corruption. Commodity trading companies often purchase oil, gas and minerals directly from NOCs or national mining companies (NMCs). This is particularly relevant in oil trading as NOCs control around 80 per cent of global oil reserves (UNCTAD, 2020[2]). According to an OECD study, SOEs were involved in 20 per cent of the 131 reported corruption cases in the extractives sector and have elevated corruption risks, as compared to other sectors of the economy (OECD, 2014[7]).

6. As part of the Thematic Dialogue on Commodity Trading Transparency, this report maps out corruption risks across the commodity trading value chain to raise awareness

about the importance of enhanced transparency in commodity trading, and to inform possible normative developments in commodity trading hubs with respect to new corporate transparency and reporting requirements.

7. Commodity trading hubs have a key role to play in improving transparency and accountability in commodity sales transactions that relate to the state's share of production and should take active steps to avoid the reputational risk of harbouring transactions tainted by corruption or otherwise suspicious deals, by closing international opportunities that allow individuals to get away with corruption.

8. A significant share of global commodity trading transactions take place in several key global trading hubs. For example, a report by the Swiss Federal Government in 2013 estimated that 60 per cent of global trade in metals and 35 per cent of crude oil takes place in Switzerland. In terms of the global trade in oil, London has a market share of 25 per cent, followed by New York (20 per cent) and Singapore (15 per cent). In terms of the global trade of metals and minerals, both Singapore and Shanghai have a market share of 20 per cent (Federal Council, 2013[8]).

9. There is an opportunity for these key trading hubs to show leadership in advancing the transparency and accountability agenda in extractives, by tackling the huge and largely overlooked corruption risks associated with the sheer magnitude of volumes and payments involved in commodity trading, compared to the tax and royalties paid by extractive companies to governments for the extraction of oil, gas and minerals.

10. These corruptions risks can arise at several points across the commodity trading value chain.

Figure 1.1. Commodity Trading Value Chain

11. Home jurisdictions of commodity trading companies, trading hubs, host governments and SOEs, and commodity trading companies all have a role to play in addressing corruption risks across the commodity trading value chain.

2. Corruption risks of cross-cutting relevance across the commodity trading value chain

Figure 2.1. Corruption risks of cross-cutting relevance across the commodity trading value chain

Box 2.1. Red flags of corruption risks of cross-cutting relevance across the commodity trading value chain

- Unclear opaque ownership and governance structures of commodity trading companies;
- A lack of transparency over the beneficial ownership of key actors;
- The existence of opaque joint ventures between SOEs and commodity trading companies;
- Excessive complexity in a corporate vehicle structure;
- The existence of PEPs in a commodity sales transaction;
- The use of intermediaries to facilitate a transactions; and
- A lack of due diligence by commodity trading companies on their business partners.

Opacity of ownership and governance structures of key actors involved in commodity trading

12. The complex and opaque ownership and governance structures of key actors in the commodity trading sector may constitute a significant corruption risk. This may be observed for example in the case of SOEs that create subsidiaries for commodity trading activities in purchaser and consumer countries; or in the case of commodity trading companies using multiple entities with holdings and subsidiaries registered in different jurisdictions, and front companies to conceal ultimate beneficial ownership (OECD, 2016[5]).

13. In terms of SOEs selling publicly-owned commodities, it is quite common in the business of oil trading to see NOCs create separate subsidiaries for their trading activities. In some cases, these NOCs may form joint ventures arrangements with commodity trading companies to market their commodities. The complex and often opaque ownership structure of these entities and the lack of information on shareholding and beneficial ownership may facilitate corrupt practices (OECD, 2016[5]).

14. Furthermore, there is often a lack of transparency of general information about the activities of SOEs. Research from the NRGI into the reporting practices of 45 SOEs showed that 18 of those SOEs are under no legal obligation to report information about their operations. Furthermore, 25 of those SOEs did not publish audited reports or, if so, published them more than two years late. Only six of these SOEs are listed on a stock exchange and are therefore legally obliged to report their finances (Longchamp and Perrot, 2017[6]).

15. In terms of the companies purchasing publicly-owned commodities from SOEs, these can be refineries or other end-users, international oil companies, banks, large independent commodity trading companies, and small trading companies with little logistical and financial capacity.

16. These purchasing companies may be part of a wider corporate structure with multiple entities with holdings and subsidiaries registered in different jurisdictions, rendering the transaction more opaque and the money flows being more difficult to track. Offshore companies may be used by purchasing companies to hide their involvement in opaque or corrupt trading activities, and to conceal the beneficial owners including any possible involvement of a PEP (OECD, 2016[5]).

Use of corporate vehicles in commodity trading transactions

17. Commodity trading companies use corporate vehicles to undertake their operations and to structure their ownership. The use of various corporate vehicles may result in the introduction of complexity and opacity in respect of the ownership and governance structures of commodity trading companies and may also reduce transparency and oversight surrounding commodity trading transactions.

18. Corporate vehicles refer to entities that conduct a wide variety of commercial and entrepreneurial activities. These can include: companies, trusts, foundations, partnerships, joint ventures, and other types of legal persons and arrangements. In many cases, these vehicles have an essential and legitimate role to play in the global economy. However, they can be misused for illicit purposes, including money laundering, bribery and corruption, insider dealings, tax fraud, terrorist financing, and other illegal activities (FATF, 2014[9]).

19. Excessive complexity in a corporate vehicle structure can be regarded as a “red flag” indicator of risk. In a tiered corporate vehicle structure, layers of legal entities and/or arrangements can be inserted between the individual beneficial owner and the assets of the primary corporate vehicle.

20. For example, a major commodity trading company, registered in a major trade hub was charged by the New York District Attorney's Office for its involvement in a scheme to pay kickbacks to government representatives in connection with the purchase of oil. The commodity trading company used an associated entity to send the kickbacks to accounts controlled by the government representatives (TRACE International, 2020[10]).

Use of front companies to purchase commodities

21. Commodity trading companies may rely on the use of front companies as a specific corporate vehicle to structure their operations. Front companies refer to entities that are used to obscure the identification of an owner, share-holder or beneficiary of another company.

22. The OECD Corruption Typology analysed 130 cases of corruption in the natural resources sector. Of the 130 cases in that study, 21 consisted of complex operations involving different front companies (OECD, 2016[5]).

23. Commodity trading companies may use front companies to act on their behalf or as a sort of quasi-subsidiary – acting in the interest of the commodity trading company as an extension of its business interests. This mechanism may be used to conceal questionable operations or to hinder legal proceedings. Front companies may be part of a larger, sprawling and complex web that makes identification of individuals almost impossible as the front companies will be identified as the formal buyer of the commodity, prior to reselling it to a more established trading company. Front companies are generally located in jurisdictions whose anti-money laundering provisions are less developed (Longchamp and Perrot, 2017[6]).

24. For example, a large commodity trading company, headquartered in a major trading hub, entered into an opaque alliance with a PEP, which resulted in the establishment of a subsidiary that entered into swap agreement in resource-rich developing country to export crude oil in exchange for providing refined petroleum products for the domestic market. The subsidiary was registered in another major trading hub and one of its directors is also the founder of the commodity trading company. Over several years, the subsidiary was able to engage in commercial activities in the resource-rich country, with one of its refining contracts being estimated at USD 3.3 billion in 2011 (Berne Declaration, 2013[11]).

25. In another example, a large commodity trading company, headquartered in a major trading hub, utilised front companies to purchase crude oil from Iraq under the United Nations Oil-for-Food Programme. The commodity trading company financed a previously dormant company in Malaysia in order for that revived company to purchase 33 million barrels of crude oil on its behalf. The Malaysia company paid surcharges (illegal payments) to Iraqi authorities, financed in part by commissions received from the commodity trading company (Volcker, Goldstone and Pieth, 2005[12]).

26. In a further example of the use of front companies, several companies were granted rights to lift billions of dollars of commodities in a resource-rich developing country. These companies were all controlled by the same individual who was a cousin of the relevant minister of commodities. It was alleged that these companies did not have the requisite capability and experience to be awarded these lifting rights on a competitive basis as they were acting as front companies for the relevant minister. Notably, once judicial proceedings against the minister had commenced, these companies disappeared from the market.

Use of joint venture structures in commodity trading transactions

27. Joint ventures are a flexible form of corporate identity that two or more parties can use in order to execute a business undertaking. Joint ventures can be used for a wide variety of legitimate purposes and are a common corporate vehicle utilised by different actors in the extractive sector. However, they can be misused to facilitate corruption schemes in several different ways.

Box 2.2. OECD Definition of a joint venture

A joint venture is a contractual agreement between two or more parties for the purpose of executing a business undertaking in which the parties agree to share in the profits and losses of the enterprise as well as the capital formation and contribution of operating inputs or costs. It is similar to a partnership […], but typically differs in that there is generally no intention of a continuing relationship beyond the original purpose. A joint venture may not involve the creation of a new legal entity. Whether a quasi-corporation is identified for the joint venture depends on the arrangements of the parties and legal requirements. The joint venture is a quasi-corporation if it meets the requirements for an institutional unit, particularly by having its own records. Otherwise, if each of the operations is effectively undertaken by the partners individually, then the joint venture is not an institutional unit and the operations would be seen as being undertaken by the individual partners to the joint venture. Because of the ambiguous status of joint ventures, there is a risk that they could be omitted or double-counted, so particular attention needs to be paid to them.

Source: (OECD, 2008[11])

28. Commodity trading companies may decide to form a joint venture with another entity to reduce commercial risk, to comply with the local content requirements of a particular jurisdiction, or to increase its chances of being awarded a sales contract. In some jurisdictions, commodity trading companies choose to establish joint ventures with PEPs in resource-rich countries in order to access local commodity markets.

29. Where buyers gain market access by entering into joint ventures with PEPs, the buyer may be awarded preferential contractual terms for the purchase of commodities due its association with the PEP. These structures can be used to distribute dividends to joint venture participants on the basis of their share in the joint venture. This can act to obscure the identities of the beneficial owners and the involvement of the PEPs.

30. For example, a large commodity trading company, headquartered in a major trading hub, entered into an arrangement to purchase commodities from a SOE in a resource-rich country. This arrangement involved setting up a joint venture between the commodity trading company and a PEP who was a relative of the president and also had a significant management position in a large SOE. The joint venture structure is complex and involves numerous subsidiaries registered across numerous jurisdictions. Over several years, the joint venture paid over USD 1 billion in dividends to its shareholders, one of which is a PEP (Public Eye, 2018[12]).

31. Joint ventures may also be used as a corporate vehicle to insert distance between the buyer and an entity that is engaged in paying bribes. For example, four European and North American companies formed a joint venture to bid for contracts in a gas project in a resource-rich developing country. One of the joint venture participants deliberately avoided direct ownership in the joint venture, choosing instead to retain an indirect ownership interest in the joint venture through a partially-owned company registered in another jurisdiction. Senior executives of the joint venture decided to bribe officials in order to win contracts and appointed consultants in order to facilitate the bribery (OECD, 2009[13]).

32. In other scenarios, buyers may enter into joint ventures with SOEs or their subsidiaries. These joint ventures can create conflicting incentives for the SOE who finds

itself on both sides of the transactions, and these blurring of roles may open the door to corruption and public rent diversion.

33. For example, a NOC from a major resource-rich developing country set up a joint venture entity in a Caribbean jurisdiction with a large commodity trading company, from a major trading hub. Once this corporate structure was in place, the NOC sold crude oil to the joint venture entity below market value. In this case there was no evidence that corrupt practices took place, but this example does highlight the potential risks that can be created through the use of a joint venture structure (Gillies, Guéniat and Kummer, 2014[14]).

Concealment of beneficial owners of buyers

34. Corporate vehicles can be used by both buyers and sellers in commodity trading transactions to conceal a beneficial owner who stands to benefit unjustly from a particular transaction or from an on-going corruption scheme. In the absence of transparency of beneficial ownership, commodity trading transactions can be conducted by anonymous shell companies, which are conducive to corruption, conflicts of interest and tax evasion (UNCTAD, 2020[2]).

35. The beneficial owner(s) of the buyer refers to the natural person(s) who directly or indirectly ultimately own or control the buyer. This is distinct from the 'legal owners' who are the persons or companies listed as direct owners in a company's corporate registration, tax returns, licences or contracts. Beneficial owners can exercise significant control or influence over the legal owners and can ultimately be the beneficiary of any profits received by the legal owners.

Box 2.3. FATF Definition of beneficial ownership

Beneficial owner refers to the natural person(s) who ultimately* owns or controls a customer** and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.

* Reference to "ultimately owns or controls" and "ultimate effective control" refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.

** This definition should also apply to beneficial owner or a beneficiary under a life or other investment linked insurance policy.

Source: (FATF, 2012[15])

36. Beneficial ownership is often disguised using a complex web of corporate vehicles to isolate the beneficial owner from the legal (declared) owner. Adding numerous layers of ownership between an asset and the beneficial owner in different jurisdictions, and using different types of legal structures, can frustrate investigations and make detection of the beneficial owner more difficult (FATF & Egmont Group, 2018[16]). Beneficial ownership information can be obscured through the use of: (FATF, 2014[9]).

- shell companies[1] (which can be established with various forms of ownership structure) especially in cases where there is foreign ownership which is spread across jurisdictions;
- complex ownership and control structures involving many layers of shares registered in the name of other legal persons;
- bearer shares and bearer share warrants;
- unrestricted use of legal persons as directors;
- formal nominee shareholders and directors where the identity of the nominator, or even the existence of a nominee contract, is undisclosed;
- informal nominee shareholders and directors, such as close associates and family;
- trusts and other legal arrangements which enable a separation of legal ownership and beneficial ownership of assets; and
- use of intermediaries in forming legal persons, including professional intermediaries.

37. In the extractives sector, there is evidence that hidden ownership information is a major risk factor for corruption. The NRGI reviewed 100 oil, gas and mining corruption cases from 49 countries, and found that over half of these cases involved companies with hidden beneficial owners (Sayne, Gillies and Watkins, 2017[17]). The ONE Campaign has undertaken analysis on the complex and opaque ownership structure that often sits behind extractive companies and estimates that developing countries lose USD 1 trillion each year as a result of corrupt or illegal cross-border deals, many of which involve companies with unclear ownership (ONE, 2014[21]).

Involvement of politically exposed persons in commodity trading transactions

38. Politically exposed persons (PEPs) may be involved in commodity sale transactions through the use of complex corporate and legal structures, including intermediaries, briefcase or shell companies, or by entering into joint ventures with the buyer. The risk of PEP involvement may be heightened in situations where contracts are awarded to local companies – either awarded outright or in a partnership between a local and an international buyer.

39. A PEP refers to a natural person who has been entrusted with prominent public functions. This may include senior members of the government or other such senior officials in the administration, judiciary, police, military or employees of SOEs.

40. It is important to note that the PEP status itself does not necessarily mean an individual is corrupt or that they have been involved in any corrupt practice – but it does raise a red flag that should require further scrutiny.

Box 2.4. FATF Definition of politically exposed persons

[1] Shell companies are considered to be companies that are incorporated and that have no significant operations or related assets.

Foreign PEPs are individuals who are or have been entrusted with prominent public functions by a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials.

Domestic PEPs are individuals who are or have been entrusted domestically with prominent public functions, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials.

Persons who are or have been entrusted with a prominent function by an international organisation refers to members of senior management, i.e. directors, deputy directors and members of the board or equivalent functions.

The definition of PEPs is not intended to cover middle ranking or more junior individuals in the foregoing categories.

Source: (FATF, 2012[15])

41. Due to their power and influence, PEPs are often in positions that can be abused for the purpose of corruption, public rent diversion or other illicit activities. PEPs often use corporate vehicles to obscure their identity, in order to distance themselves from transactions, and to access the financial system undetected (FATF, 2013[19]).

42. Several cases have been documented where commodity trading companies have formed partnerships with PEPs who are then able to obtain lucrative contracts, either directly with representatives of the government authorities or with individuals close to them (Public Eye, 2018[20]).

43. For example, a commodity trading company based in a major trading hub obtained shipments of USD 2.2 billion of oil from a NOC in a resource-rich developing country. The deal was negotiated by intermediaries, one who was a close advisor of the president, and who was considered a PEP under the law of the trading hub where the commodity trading company was based.

44. In another example, a commodity trading company based in a major trading hub entered into a partnership with a senior military official in a resource-rich developing country to secure access to oil sales. A joint venture was set up between the commodity trading company and the senior military official, who was also a close advisor of the president, to present the official as a co-investor. Using this partnership with the PEP, the commodity trading company was able to secure oil shipments in excess of USD 3 billion (Public Eye, 2018[20]).

Use of intermediaries in commodity trading transactions

45. The use of intermediaries by commodity trading companies to facilitate the sale and purchase of commodities trading transactions has been well documented by various civil society organisations and investigative agencies. The use of intermediaries represents one of the most illicit financial flows (IFF)-vulnerable stages in the global commodity trading value chain and can create opportunities for corruption, including mis-invoicing, and other channels for IFFs (Enger et al., 2020[21]).

46. Buyers may choose to engage the services of an intermediary to help facilitate a commodity sale transaction. An intermediary may be a legal or a natural person. An

intermediary may help facilitate the transaction between the buyer (trader) and the seller (government) or may themselves act as the buyer in the transaction before quickly off-selling the commodity to the trader.

Box 2.5. OECD Definition of intermediaries

A person who is put in contact with or in between two or more trading parties. In the business context, an intermediary usually is understood to be a conduit for goods or services offered by a supplier to a consumer. Hence, the intermediary can act as a conduit for legitimate economic activities, illegitimate bribery payments, or a combination of both.

Source: (OECD, 2009[13])

47. The involvement of intermediaries in corrupt transactions worldwide has been largely documented. At least 71% of all 427 bribery cases reported by the signatory countries of the OECD Anti-Bribery Convention in the period from 1999 to 2014 involved the use of an intermediary (OECD, 2014[7]). Analysis undertaken by Stanford Law School of 240 United States Foreign Corrupt Practices Act (FCPA) cases from 1977 to 2017 found that more than 90% of these cases also involved an intermediary (Moretti, 2018[22]).

48. In commodity sales transactions, a common example concerns a corruption scheme where the buyer pays the intermediary a fee for his services, and then the intermediary pays bribes the public official who is responsible for selecting the buyer of a specific sale of commodities. In this example, the intermediary acts as a ‘shield’ between the buyer and the corrupt payment (bribe) to the public official.

49. However, the use of an intermediary in this context may not necessarily protect the buyer from criminal liability. The OECD Anti-Bribery Convention expressly covers the situation where foreign bribery is committed “directly or through intermediaries” and consequently any buyer relying on the use of intermediaries to make corrupt payments would be committing a criminal offence in jurisdictions that are signatories to the OECD Anti-Bribery Convention (OECD, 1997[23]).

50. The use of an intermediary company without any operational activities or history, or where the identity of the company’s ultimate beneficiaries is obscured constitute red flags, alerting the buyer to the possibility that the commodities were obtained under questionable conditions (Longchamp and Perrot, 2017[6]).

51. By way of example, a NOC in a major resource-rich developing country regularly sold shipments of the state’s oil to three intermediary companies, who then on-sold the shipments to large international traders. Investigations by civil society organisations found that a senior NOC official owned large concealed stakes in all three intermediary companies, and that some of the companies made exorbitantly high-interest loans to the NOC in exchange for discounted oil. Furthermore, one of the intermediary companies reportedly paid companies owned by a family member of the president for unknown consulting services (Sayne and Gillies, 2016[4]).

52. In another example, a commodity trading company with little experience in trading and headquartered in a major global trading hub entered into an exclusive arrangement to export refined products from a state owned refinery in a resource-rich country. The commodity trading company acted as an intermediary between the state-owned refinery and the international market, reselling its cargoes to third parties without adding any further

value. The commodity trading company was owned by a single shareholder who was a friend of a relative of the President of the resource-rich country (Longchamp and Perrot, 2017[6]).

53. In other situations, intermediaries may be natural persons who help facilitate the transaction between the buyer (trader) and the seller (SOE). In one example, an intermediary acting as an agent for a large commodity trading company headquartered in a major global trading hub was involved in multiple bribery schemes in collaboration with insiders at a SOE. The agent was paid for his services by the commodity trading company through an offshore company. The agent was subsequently charged with corruption and money-laundering by the home jurisdiction of the SOE (Global Witness, 2018[24]).

54. In another example, a commodity trading company was held criminally liable by the Office of the Attorney General of Switzerland for failing to take all the organisational measures that were reasonable and necessary to prevent its agents from bribing public officials in order to gain access to the petroleum markets in two resource-rich developing countries. The investigation revealed that the commodity trading company had no formal selection process for any of the agents that it used and it did not carry out any checks on their activities, despite the fact that Swiss and international anti-corruption standards (OECD, ICC, SECO) specifically highlight the increased risk of corruption associated with agents' activities. The commodity trading company was ordered to pay the sum of CHF 94 million (Office of the Attorney General of Switzerland, 2019[25]).

55. In another example, a subsidiary of a different commodity trading company also headquartered in a major global trading hub, paid approximately USD 2 million to a father-and-son team of local brokers. This pair of brokers were subsequently accused of arranging bribes with an SOE, and references to these bribery payments were included in a financial report prepared for a director of the SOE (Global Witness, 2018[24]).

Lack of or insufficient corporate due diligence

56. The lack of due diligence and compliance procedures by financial institutions, banks, trading companies and their business partners involved in commodity trading renders the effective prevention and detection of corruption risks more difficult (OECD, 2016[5]).

57. This can give rise to illicit transactions involving PEPs or other intermediaries, and these risks can be exacerbated where there is not a clear supply chain policy for identifying and managing risks.

58. For example, a large multinational enterprise plead guilty in a court in the United States for illegally bribing officials of a government in relation to the purchase of alumina by using a consultant to facilitate corrupt payments. The Securities Exchange Commission determined that the multinational enterprise did not conduct due diligence or otherwise seek to determine whether there was a legitimate business purpose for the use of a middleman (TRACE International, 2020[10]).

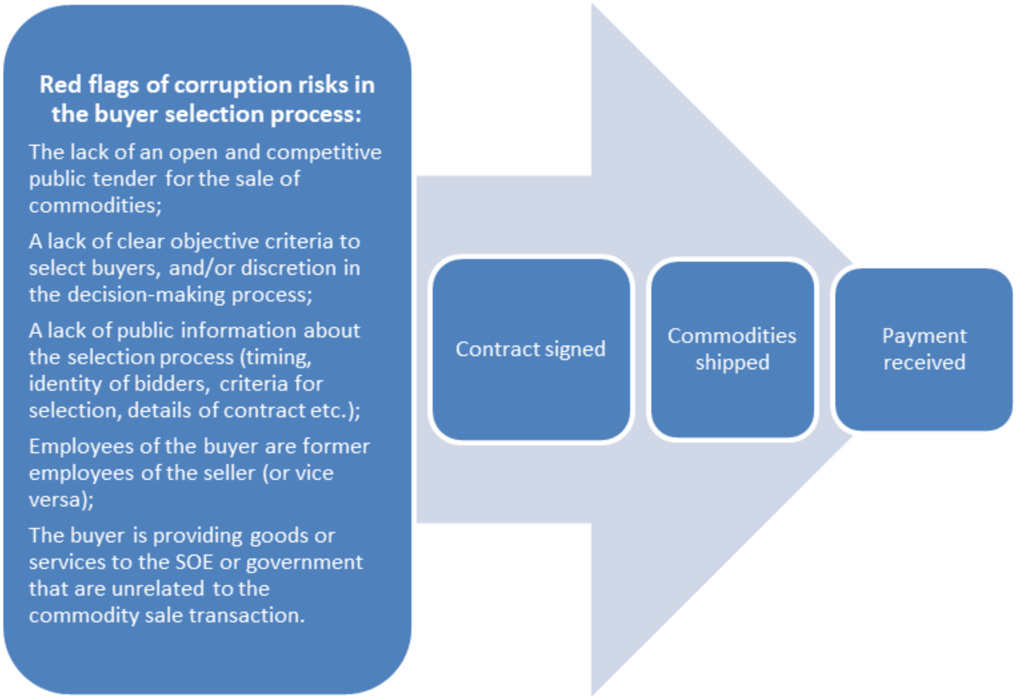
59. Commodity trading companies can minimise this risk by undertaking robust due diligence and compliance procedures in accordance with relevant international, national, and industry standards. This may include internal and external compliance audits, adopting a know-your-customer and know-your-business policy, asking for information about the corporate structure and the full ownership or board members of trading counterpart, but also of any intermediary in the supply chain (e.g. shipping company, the inspecting

company, the refineries, etc.) with a zero ownership threshold (OECD Development Centre, 2018[27]).

60. Trading hubs and home jurisdictions of commodity trading companies can contribute to mitigating the risk of a lack of due diligence and compliance procedures by passing legislation to require commodity trading companies to carry out rigorous due diligence on their business partners, to prevent illicit transactions with politically exposed persons or other intermediaries, and on their supply chain to verify the origin of the commodities, and the conditions under which they are acquired, in particular when sourcing from high-risk areas (OECD, 2016[5]).

3. Corruption risks in the buyer selection process

Figure 3.1. Corruption risks in the buyer selection process



Opacity of the selection of buyers

61. The lack of transparency and oversight in the sale of a government's share of publicly-owned commodities, provides opportunities for corruption. These corruption risks are especially prevalent at the buyer selection stage and are exacerbated by the large amounts of money involved and the strong interaction of the buying companies with state authorities (Longchamp and Perrot, 2017[6]).

62. Governments or SOEs will undertake an allocation process to select buyers to enter into commodity sale agreements. This process may involve the buyer submitting a bid or tender in a competitive bidding process or the buyer conducting a direct negotiation with the government to purchase commodities.

63. The lack of an open and competitive public tender for the sale of commodities may lead to suboptimal allocation and overly favourable contractual terms for the buyer at the expense of the government. This may occur in particular where a trading company offers little value added and acts as a mere intermediary between the government (often represented by a SOE) and a second-tier purchaser (OECD, 2016[5]).

64. In situations where commodities are sold through a competitive bidding process, additional risks may arise where bidders collude to manipulate the outcome of the bidding process. The OECD Development Centre has developed guidance for SOEs on buyer selection which provides steps that SOEs can take to identify and prevent buyer collusion.

65. The use of inappropriate commodity pricing benchmarks may affect the return that a government receives for the sale of its commodities. Corruption risks may be heightened for commodity sales where there is a lack of publicly quoted prices for the commodity, as is the case with some minerals.[2]

66. The allocation process for selecting buyers of publicly-owned commodities is often opaque. Research from the U4 Anti-Corruption Centre found that in states where SOEs are responsible for selling natural resources, public tenders are rarely published on portals or in official journals. Furthermore, the results of those tenders are published even less often (Longchamp and Perrot, 2017[6]).

67. The disclosure of the allocation method (competitive bidding process or direct negotiation) used for the purchase of the publicly-owned commodities can provide useful context on the sale and how a particular buyer was selected, and may also raise red flags where further investigation may be warranted. For example, a 2015 investigation into commodity trading transactions by Public Eye discovered that a state-owned oil refinery had awarded a contract to export refined petroleum products to a buyer without a public tender process, despite it being illegal under that states national law to award public contracts without a tender process (Public Eye, 2018[20]).

68. The exercise of discretion in the buyer selection process is a major risk factor and can undermine the effective prevention of corruption and can result in significant public rent diversion. Discretionary decision-making can result in the selection of buyer who may purchase the commodities for less than their market value. In practice, these 'unqualified' buyers are often intermediaries, who purport to act as the buyer in the transaction purchasing the commodity at a low price before quickly off-selling the commodity at a market price on the international market, without providing any logistical or other reasonable service. The buying company thus acts as a mere intermediary between the public entity or its marketing agent and a second-tier purchaser (OECD, 2016[5]). The OECD Development Centre's guidance for SOEs on buyer selection provides detailed guidance on reducing discretion in the buyer selection process by developing a pre-qualification process, setting out pre-defined criteria, and using a weighting system to assess a prospective buyer against that criteria.

69. The risk associated with the opacity of the selection of buyers is linked to other risks in the commodity trading value chain – including the opacity over the ownership and governance structures of the key actors involved and the lack of transparency over the key terms of the commodity trading transaction – see sections 2 and 4.

70. The opacity and the lack of oversight in the sale of publicly-owned commodities can provide opportunities for corruption. For example, an inexperienced company based in a major trading hub and run by a friend of a PEP from a major oil exporting country was able to secure large shipments of oil, without any public tender, from authorities in that oil exporting country. Those shipments were then re-sold at a higher price (Chêne, 2016[28]). Furthermore, the contract contained numerous clauses that directly harmed the public finances of that oil exporting country (Public Eye, 2018[20]).

71. In another example, a commodity trading company based in a major commodity trading hub made payments to two shell companies controlled by a trader and a former

[2] For further guidance on the use of commodity pricing see OECD Development Centre (2020 forthcoming), *How to Select Buyers of Oil, Gas and Minerals: Guidance for State-Owned Enterprises*, OECD Development Policy Tools, OECD Publishing, Paris.

adviser to a president of a resource-rich country. The trader and adviser reportedly secured meetings between employees of the commodity trading company and senior government officials in another resource-rich country, including the president. Following those meetings, the commodity trading company was selected to purchase several million barrels of crude oil from the NOC (Sayne and Gillies, 2016[4]).

72. A transparent and robust competitive bidding process can reduce opportunities for corruption and public rent diversion if a sufficient number of credible bidders are able to respond to the invitation to tender, have an incentive to compete for the contract, and the seller's discretion is limited.[3] SOEs should set pre-determined and objective buyer selection criteria and introduce standardised and automatic procedures, and make information related to all stages of bidding processes publicly available to all stakeholders.

73. However, in some specific contexts there are legitimate strategic and economic reasons why sales are conducted using a direct negotiation method. For example, government-to-government transactions; resource-backed financing agreements, and arrangements in which international oil companies lift and sell the government share of production, if this is already set out in an existing production sharing agreement (OECD, 2019[29]).

74. Robust governance arrangements for SOEs are particularly important to ensure that SOEs are resourced to undertake a buyer selection process. Risk factors related to the governance of SOEs include lack of or insufficient segregation of roles and responsibilities between administrative, regulatory and supervisory functions. In many instances, state-owned companies act as both as the administrator and regulator of the sector.

Use of bribery to secure commodities

75. Bribery involves intentionally offering, promising or giving any undue pecuniary or other advantage to an official or decision maker, with the intention that the official or decision maker acts or refrains from acting in relation to the performance of their duties. Bribery to secure contracts or obtain access to natural resources on uncompetitive terms is a particular problem in the commodities sector (Chêne, 2016[28]).

76. Bribery mechanisms can include kickbacks, secret commissions, and facilitation payments. For example, direct commissions may be paid by a prospective buyer to a public official or decision maker in a SOE or government agency in exchange for the purchase of commodities under advantageous conditions. In other cases, buyers may use intermediaries to pay the commission. These may be individuals or opaque corporate vehicles that are controlled by corrupt officials that extract benefits from a commodity trading transaction at the expense of the state.

77. These corruption schemes are often set up to shield the identity of a PEP who may control, or otherwise have influence over, the allocation process. The detection of these schemes can be challenging when intermediaries and offshore structures are placed between the buying company and the PEP being bribed. For example, illicit payments may flow through a different jurisdiction than the one where the opaque corporate vehicle (front company) is created. These financial flows and the front company may be part of a larger

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[3] The OECD Development Centre has developed guidance for use by SOEs on buyer selection procedures in order to reduce corruption risks in commodity trading. *How to select buyers of publicly owned oil, gas and minerals: Guidance for SOEs* will be released at the Fifteenth Plenary Meeting on 4 December 2020.

and complex corporate structure that makes the identification of the key individuals involved very difficult (Longchamp and Perrot, 2017[6]).

78. In another example, a commodity trading company allegedly paid USD $700,000 in bribes to the CEO of the oil and gas regulator in a resource-rich country to secure access to oil and gas. Following an investigation by the local anti-corruption commission, the CEO was arrested, and the oil and gas regulator was forced to suspend all public tenders for oil and natural gas sales (TRACE International, 2020[10]).

Existence of conflicts of interest between buyer and seller

79. Conflicts of interest in both the public and private sector have become a major matter of public concern worldwide. When conflict-of-interest situations are not properly identified, disclosed and managed, they can endanger the integrity of organisations and result in corruption and public rent diversion.

Box 3.1. OECD Definition of conflict of interest

A "conflict of interest" involves a conflict between the public duty and private interests of a public official, in which the public official has private-capacity interests which could improperly influence the performance of their official duties and responsibilities.

Source: (OECD, 2003[31])

80. A framework that provides for the disclosure of conflicts of interest can help to identify and capture any additional red flags associated with the relationship between the buyer and the seller. This may include whether any employees of the buyer are former employees of the seller (or vice versa), whether the buyer has access to any information in respect of the commodity sale that other rival companies did not, or where the buyer is providing goods or services to the seller (or government) that are unrelated to the commodity sale transaction.

81. In Nigeria, crude oil tender requirements recognise the risks arising from conflicts of interests. Buyers participating in a competitive tender for the purchase of crude oil from the Nigerian National Petroleum Corporation (NNPC) must provide a sworn affidavit to "*confirm whether or not any of the members of relevant companies of NNPC or Bureau of Public Procurement (BPP) is former or present Director, Shareholder, or has any pecuniary interest in [the bidding] company*" (NNPC, 2018[32]).

82. While a conflict of interest is not necessarily evidence of corruption itself, there is increasing recognition that conflicts between the private interests and public duties of public officials, if inadequately managed, can result in corruption. It should also be recognised that as all public officials have legitimate interests which arise out of their capacity as private citizens, conflicts of interest cannot simply be avoided or prohibited, and should be identified, disclosed, and managed.

83. Recommendations for mitigating risks associated with conflicts of interest are set out in the OECD Development Centre's guidance for SOEs on the selection of buyers of oil, gas and minerals. SOEs should require buyers to disclose any conflict of interest but should also undertake their own analysis to identify and capture any additional red flags associated with the relationship between the buyer and the seller. SOEs should be

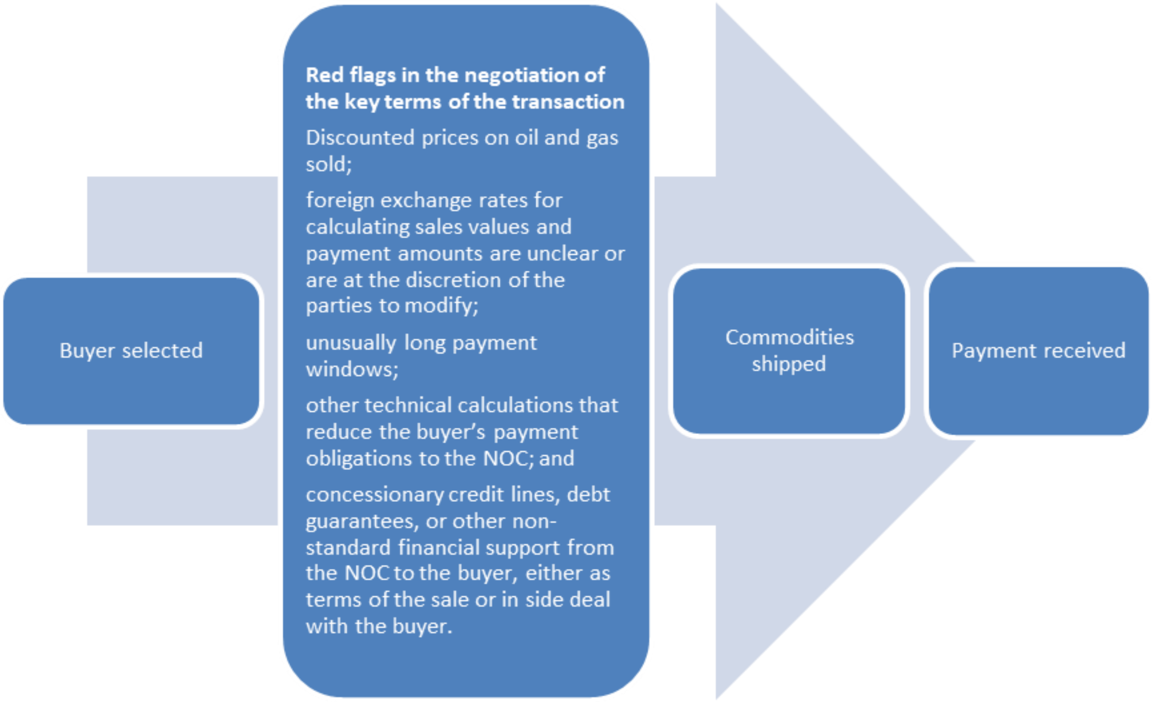
particularly cognisant of the movement of personnel between SOEs and buyers (often termed ‘revolving doors’).

84. SOEs should also put in place robust procedures to identify and manage conflicts of interest in their buyer selection teams. This may include: prohibiting specific unacceptable forms of private interest; making employees aware of the circumstances in which conflicts can arise; and ensuring that effective procedures are deployed for the identification, disclosure, management, and promotion of the appropriate resolution of conflict-of-interest situations.[4]

[4] For further guidance on the mitigation of conflicts of interest, see OECD Development Centre (2020 forthcoming), *How to Select Buyers of Oil, Gas and Minerals: Guidance for State-Owned Enterprises*, OECD Development Policy Tools, OECD Publishing, Paris.

4. Corruption risks in the terms of the agreement

Figure 4.1. Corruption risks in the terms of the agreement



Source: Adapted from (Sayne and Gillies, 2016[25])

Lack of transparency of the key terms of the transaction

85. Not all 'bad deals' are direct result of corruption. Other factors that can influence whether a state receives a sub-optimal return for the sale of its natural resources include where governments' prioritise short-term returns over long term gains (e.g., by negotiating a resource-backed loan with costly repayment terms in order to generate a quick return on its natural resources), or simply bad management (Chêne, 2016[29]). Greater transparency around the key terms of the transaction, and how they are executed can improve understanding around the sale of publicly-owned commodities, promote accountability and mitigate corruption risks.

86. The lack of transparency surrounding the key terms of the transaction represents a significant corruption risk in the commodity trading sector. Corruption may occur where there is insufficient disclosure of disaggregated data on: volumes received by SOEs; commodity sales by SOEs; revenue streams and financial transfers to and from SOEs and to and from governments.

87. Corruption risks may arise in the jurisdictions where commodity trading companies are registered and where they carry out business. These risks may include a lack of requirements for payments disclosure by commodity traders and their business partners, and the lack of harmonisation across national jurisdictions with regard to disclosure

requirements, including information on commodity trading related payments and beneficial ownership (OECD, 2016[5]).

88. Unbalanced contractual terms can directly reduce the return received by a state for the sale of its natural resources, and these losses can be significant given the high value of the sales involved. For example, a commodity trading company with little experience in trading and headquartered in a major global trading hub entered into an exclusive arrangement to export refined products from a state-owned refinery in a resource-rich country. According the civil society sources, the terms of the transaction gave the parties discretion to choose exchange rates for foreign currency conversions and provided the commodity trading company with an unusually long period in which to pay the SOE for the refined products it received. Furthermore, the terms of the transaction did not require the commodity trading company to post any security for the refined products it received (Sayne and Gillies, 2016[3]).

89. For example, the OECD Corruption Typology reports the case of suspicious transactions where a small trading company with no credentials in the trading business was offered very generous contractual terms to trade refined products, despite the fact that it would provide no logistical or other reasonable service. Contractual provisions included unusual long-term repayment periods, and payments in open credit with no financial guarantee led to unbalanced terms where the seller assumed substantial risks of default (OECD, 2016[5]).

Additional risks associated with the use of non-conventional sales agreements

Resource-backed finance agreements

90. Resource-backed finance agreements allow the government to be paid for the sale of its production in advance instead of waiting for the payment on delivery. The political pressure faced in some countries to spend oil revenues quickly may lead to the negotiation of pre-payment arrangements granting favourable conditions to the buyer at the expense of the seller (e.g. discounted prices).

91. In sub-Saharan Africa, resource-backed finance agreements were first well documented in Angola in the mid-1990s, and since then have become relatively commonplace in resource-rich developing countries in sub-Saharan Africa, Latin America and beyond. Resource-backed finance agreements are ordinarily entered into by governments or by SOEs themselves. The lenders are often state-owned development banks from China and commodity trading companies (Mihalyi, Adam and Hwang, 2020[33]).

92. Recent research from the NRGI demonstrates the magnitude of the money involved in these resource-backed finance arrangements. The NRGI evaluated 52 resource backed loans across sub-Saharan African and Latin American countries which totalled USD 164 billion. This included 30 loans by countries in sub-Saharan Africa totalling USD 66 billion, and 22 loans by countries in Latin American totalling USD 98 billion (Mihalyi, Adam and Hwang, 2020[33]).

93. The corruption risks associated with the use of resource-backed finance agreements are exacerbated by opacity of the lending terms. The agreements are not usually made public, thus preventing proper scrutiny of their key terms, including the costs, repayment terms and the use of the loans.

94. Development and commercial banks publish global lending aggregates on a regular basis but rarely publicly disclose loan-level information such as interest rates, maturity, and

resource-security arrangements. Commodity trading companies generally only make substantial disclosures when repayment problems emerge. For example, one major commodity trading company, headquartered in a key global trading hub, provides a short account of loans outstanding in its yearly report, but offers no information on other key terms (Mihalyi, Adam and Hwang, 2020[33]).

95. Of the 52 loans evaluated by the NRGI in 2020, the full loan agreement was only publicly available in one out of the 52 cases. Furthermore, two thirds of those loans went to countries with a poor or failing score under the NRGIs Resource Governance Index.

96. The use of resource-backed finance arrangements may result in public rent diversion. For example, a SOE from a resource-rich developing country entered into several resource-backed finance agreements with major commodity trading companies. Although the terms were not disclosed by the parties, several of the contracts, invoices, and emails were subsequently leaked. It appears that the contracts are in violation of local law as the shipments were purchased without a required public tender and were only possible because of payments made to government officials derived from the oil revenues. Subsequently, one of the commodity trading companies was held criminally liable in its home jurisdiction (a major global trading hub) for failing to prevent its employees and agents from bribing public officials in order to gain access to commodity markets (Mihalyi, Adam and Hwang, 2020[33]).

Commodity-for-product-swap-agreements

97. Commodity for product swap agreements are often negotiated when demand for their specific commodity is low or when they cannot pay cash for the refined products that they require. These agreements are highly context-specific, and consequently there are few industry standard terms or “best practices” against which to measure them – which makes undervaluation and mispricing difficult to identify.

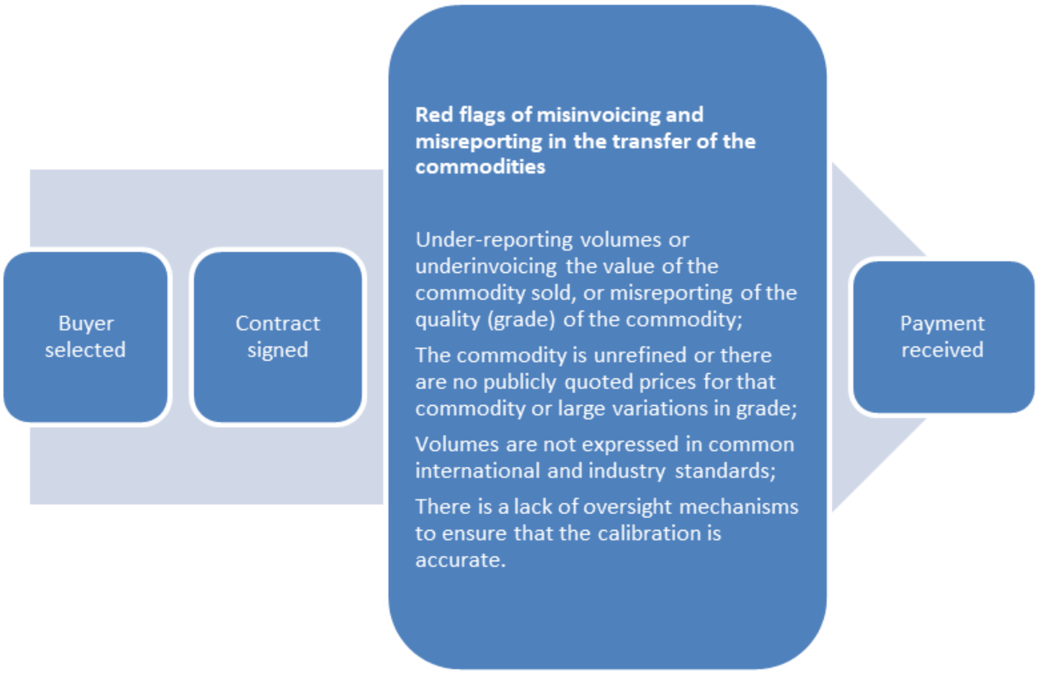
98. Commodity-for-product swap agreements may offer opportunities for corruption and misappropriation of public rent as suggested by large discrepancies observed between benchmark estimates and actual figures for government revenues in certain oil producing countries. The absence of money transfer and the secrecy surrounding contractual clauses make corrupt behaviours difficult to detect (OECD, 2016[5]).

99. A SOE from a resource-rich developing country entered into several commodity-for-product swap agreements with commodity trading companies. Official justified these need for these agreements to alleviate domestic fuel shortages. The agreements consumed roughly a fifth of the government’s share of oil production, a portion worth an estimated $35 billion in 2010 to 2014.

100. Subsequent analysis of these commodity-for-product swap agreements by the NRGI, found that some of the agreements were poorly structured and contained unbalanced or inadequately defined terms that allowed the commodity trading companies to profit at the expense of the SOE. It was estimated that that losses from a single contract could have reached USD 381 million in one year. While there is not direct evidence of corruption, it was observed that some of the commodity trading companies selected lacked fundamental trading capabilities, including the ability to market their own crude and source fuel directly from refiners. However, these companies were chosen over more experienced trading companies to manage these large transactions. Furthermore the SOE published almost no information about the deals – making independent scrutiny very difficult (Sayne and Gillies, 2016[3]).

5. Corruption risks in the transfer of the commodities

Figure 5.1. Corruption risks in the transfer of the commodities



Misinvoicing of commodities

101. Commodities (oil, gas and minerals) occur naturally in different forms and can exhibit a wide variety of different technical characteristics once mined or produced. The price of particular commodity can differ greatly depending on its grade, and therefore, governments need to be cognisant of the risk of undervaluation of commodities for export which may be symptomatic of a corruption scheme where a commodity is undervalued to allow an 'unqualified' buyer (often an intermediary) to purchase the commodity at a low price before quickly off-selling the commodity at a market price on the international market, and where the share of the windfall can serve to pay bribes (OECD, 2016[5]).

102. Misinvoicing in commodity trading usually consists of under-reporting volumes or underinvoicing the value of the resource sold, or the misreporting of the quality (grade) of the commodity. Misinvoicing provides a mechanism where the purchaser can resell the commodity at an inflated margin. A share of the windfall usually serves to pay bribes.

Misreporting of grade and valuation

103. The risk of undervaluation may be influenced by factors including: whether the commodities have been refined/processed (as unrefined products are less likely to have transparent pricing), whether there are publicly quoted prices for that commodity, spot sales, large variations in grade, and potential tax benefits that may be associated with undervaluation (IISD & OECD, 2018[34]).

Table 5.1. Risk of undervaluation for minerals and metals

Low	Medium	High
Refined base/precious metals Gold, copper, lead, zinc, nickel, cobalt, tin, aluminium, platinum, silver	**Physical concentrates** Copper silver, zinc silver, lead silver, zinc lead, cobalt nickel	**Non-metallic industrial minerals** Barite, fluorite, graphite, beryl
Bulk commodities Iron ore, coking and steam coal, manganese ore and phosphate rock	**Metallurgical products and specialty metals** Blister copper, nickel matte, alumina, gold doré	**Gemstones** Rough diamonds and other gems

Source: (IISD & OECD, 2018[34])

104. The grade of a commodity can have a significant effect on the price and therefore increased transparency around the grade and the valuation method used to determine that grade can help identify any red flags and mitigate risks of corruption in the transaction.

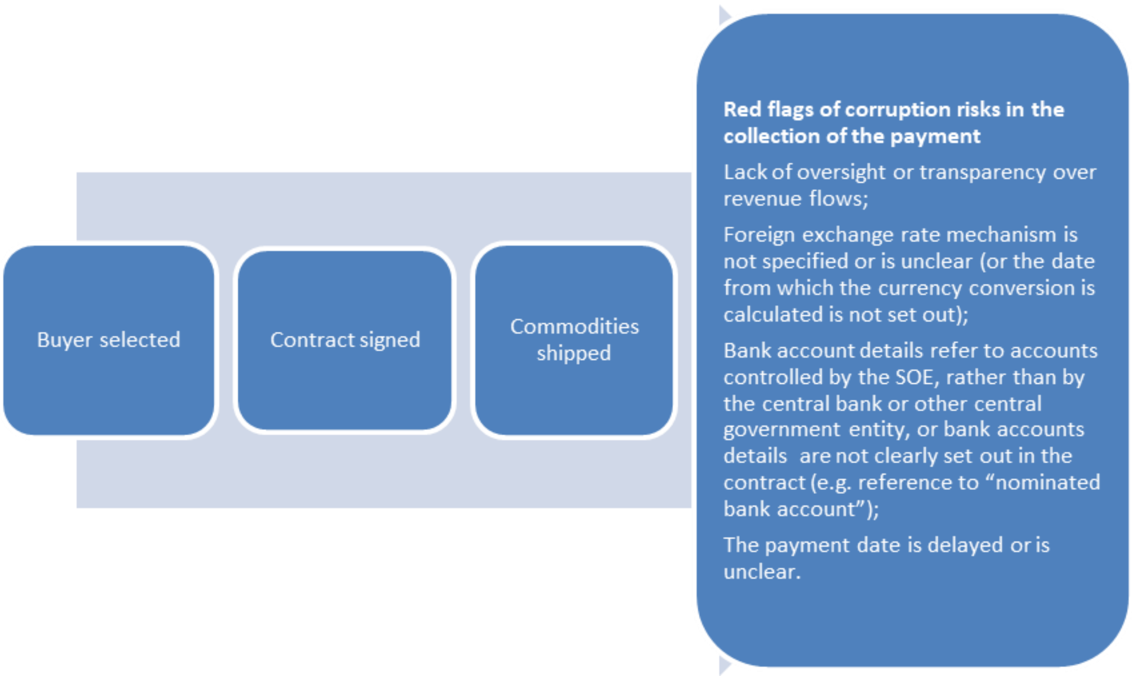
Misreporting of volume

105. It is important to ensure that volumes are not over- or underreported so that any value is not lost in a commodity transaction. There are several international and industry standards for expressing commodity volumes (bbl., MMBtu, tonnes, troy ounces etc.) that should be routinely used to reduce opacity and opportunities for manipulation and corruption.

106. In order to mitigate the opportunity for misreporting, volumes should be regularly calibrated. Normally calibrations are either done by a third party or witnessed by the other party's agent. Appropriate oversight mechanisms should be put in place to ensure that the calibration is accurate and that any opportunities for corruption are prevented or mitigated.

6. Corruption risks in the collection of the payment

Figure 6.1. Corruption risks in the collection of the payment



Opacity of the revenue flows

107. The lack of transparency surrounding the revenue flows of a transaction represents a significant corruption risk in the commodity trading sector. Corruption and public rent division may occur in the initial transaction between the SOE and the buyer, and at the subsequent stage where the revenues pass from the SOE to the central government.

108. Given the vast sums generated by SOEs from their commodity sales, it is critically important that sufficient transparency and rigorous oversight are in place to ensure that revenue flows are managed correctly.

109. The OECD Corruption Typology reports a case of substantial oil revenues, intended to be remitted to the national budget, allegedly being misappropriated in the context of the sale of the state's share of oil by the national oil company, which claimed a subsidy deduction. Other suspicious transactions suggest the diversion of rents by intermediary trading companies turning a blind eye to the misappropriation of rents through legitimate means (cashing dividends on behalf of politically exposed persons) or contributing to the creation of complex and opaque structures of corporate vehicles rendering the identification of beneficial owners more difficult (OECD, 2016[5]).

110. Research from the NRGI notes the practice of some SOEs of retaining billions of dollars in sales proceeds, including in non-transparent foreign accounts, and then spending much of these revenues "off-budget". This practice creates additional corruption risks as extra-budgetary spending of commodity sales revenues avoids the standard checks and

balances of the budget system (e.g., legislative approval, public financial management procedures etc.) (Sayne and Gillies, 2016[3]).

111. For example, in 2014, the central bank governor of a resource-rich developing country alleged that the SOE had failed to remit USD 20 billion in commodity sale revenues to the treasury over a 19-month period (Sayne and Gillies, 2016[3]).

112. In 2016, an analysis by the NRGI of 33 NOCs showed that just 22 per cent of combined total revenue they generated, including from oil sales, was directed to their countries' national treasuries (NRGI, 2019[1]).

113. Trading hubs and home jurisdictions have an opportunity to mitigate corruption risks associated with the opacity of revenue flows by requiring companies active in commodity trading to disclose all payments to governments (OECD, 2016[5]). The U4 Anti-Corruption Resource Centre has noted that the risks of revenue misappropriation arising from commodity trading transactions is increased by the lack of specific regulation and lack of specific regulators in key commodity trading hubs (Longchamp and Perrot, 2017[6]).

Manipulation of the foreign exchange rate

114. The majority of commodity trading transactions are made using United States Dollars (USD), rather than in the local currency to the producer country.

115. Due to the often significant value of a given commodity sale transaction, even a slight adjustment to the foreign exchange rate can have consequential effect on the amount that is paid by the buyer to the seller. Foreign exchange rates could be used as a means to divert public revenue for private gain, especially where the exchange rate mechanism is not clear, or where the date (from which the currency conversion is calculated) is not set out or is the wording is vague.

116. In 2015, an investigation into commodity trading transaction identified a contract between the state-owned oil refinery and an independent commodity trading company where payments to the oil refinery where made using a "mutually agreed upon exchange rate", rather than fixing a reference rate in the contract. Consequently, this transaction could have been exposed to risks of corruption and public rent diversion if the foreign exchange rate was manipulated in favour of the buyer (who may use part of its increased profits to pay bribes) and to the detriment of the state (Guéniat et al, 2015[35]).

117. Corruption risks associated with the application of foreign exchange rates can also arise at the stage where the revenues pass from the SOE to the central government. For example, a SOE allocated crude oil on an intercompany basis to its subsidiary for use in refining, swaps or export sales. It was alleged that the SOE used low exchange rates to convert USD payments into local currency, and therefore artificially reducing the amount of money that was due to be remitted to the central government (Sayne, Gillies and Katsouris, 2015[36]).

Lack of transparency of the payment account

118. The lack of transparency surrounding the use of bank accounts to receive revenues from the sale of publicly-owned commodities represents a significant risk of corruption and public rent diversion. Payment for the purchase of publicly-owned commodities may be made directly to the SOE or to another government account – for example the ministry of

finance or central bank. This will ordinarily depend on the legislative requirements or the terms of the sales contract.

119. It is important that account details are set out in the contract, or other government instrument, to avoid instances of manipulation. For example, a SOE from a resource-rich developing country executed a contract for the sale of commodities that required payment into the SOEs “nominated bank account”, rather than the contract setting out wiring instructions or bank account details (Sayne, Gillies and Katsouris, 2015[36]).

120. In other cases, payment account details can be clearly set out but may be ignored. For example, in the 1990s, the UN Oil-for-Food Programme in Iraq mandated that the proceeds of oil sales be deposited in a UN bank account in order to purchase humanitarian goods and services. Payments never reached the UN bank account but were instead transferred to Iraqi controlled banks in Jordan and Lebanon or selected Iraqi embassies (OECD, 2016[5]).

121. Research from the NRGI has highlighted several examples where SOEs or other government agencies have retained billions of dollars in sales proceeds in non-transparent foreign accounts. In one example, a SOE retained a large share of oil revenues and engaged in extensive extra-budgetary spending. This was brought to the attention of the International Monetary Fund (IMF) who identified a USD 31.4 billion shortfall in the state’s fiscal accounts. The majority of financial shortfall was linked to off-budget spending of oil sale revenues by the SOE, where the IMF noted that some funds were diverted to foreign escrow accounts for unclear reasons (Sayne and Gillies, 2016[3]).

122. In another example, a SOE from a resource-rich country kept the vast majority of its earnings in foreign bank accounts. No information about the accounts’ balances, management or outflows was published. However, investigations later found that these funds fed 75 percent of government spending (Sayne and Gillies, 2016[3]).

Manipulation of the payment due date

123. The manipulation or abuse of the payment date can represent a corruption risk. These risks can include: contractual provisions with unusual long-term repayment periods, and payments in open credit with no financial guarantee leading to unbalanced terms where the seller would assume substantial risks of default. If these risks are identified, further scrutiny may need to be applied to this particular commodity sale transaction (OECD, 2016[5]).

124. For example, there are allegations that refer to the falsification of the payment date on cargo’s bill of lading date by trading companies supplying fuel to a SOE from a resource-rich developing country. The fuel was priced using an average of published Platts quotations, and the bill of lading date determined which quotes to use. By shifting the date to a period when quotes were higher, some traders allegedly could overcharge the SOE by hundreds of thousands—or in extreme cases, even millions—of dollars for a cargo (Sayne, Gillies and Katsouris, 2015[36]).

125. However, it should be noted that there are several legitimate reasons why a buyer may be offered a delayed payment date. It is the practice of some SOEs to offer days in credit – often up to 30 days. In other cases, given that a delayed payment date represent a benefit for the buyer, this benefit may be reflected in the selling price for the commodity sale.

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