OECD Development Policy Tools

Typology of Corruption Risks in Commodity Trading Transactions



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Foreword

In 2016, the OECD Development Centre published a report on *Corruption in the Extractive Value Chain: Typology of Risks, Mitigation Measures and Incentives* (Corruption Typology), 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[1]).

The Thematic Dialogue on Commodity Trading Transparency was launched in 2017 as an integral part of the Policy Dialogue on Natural Resource-based Development in response to the call received from the 2016 London Anti-Corruption Summit. The Thematic Dialogue is in line with the high-level mandate received from the Development Centre Governing Board on 3 October 2017 (Governing Board of the OECD Development Centre, 2017[2]). It provides a multi-stakeholder platform for collaboration addressing the global and multifaceted challenges of corruption in commodity trading from both the supply and demand sides. It has produced complementary and mutually supportive tools that home countries, trading hubs, trading companies and producing countries, including state-owned enterprises, can use to reduce drivers of corruption, increase transparency and improve accountability in commodity trading.

This report was prepared in response to a demand to identify and raise awareness around evolving corruption patterns in commodity trading. It builds on the analysis contained in the 2016 Corruption Typology and delves deeper into corruption risks of cross-cutting relevance for the sales of oil, gas and minerals – focusing on the commonalities between oil, gas and minerals rather than the specificities of each commodity. The report draws from a number of in-depth consultations with resource-rich developing countries that have taken place over the last three years in the framework of the Thematic Dialogue on Commodity Trading Transparency, as well as from an analysis of a sample of concluded and ongoing corruption cases. The sample of cases reviewed has been compiled using publicly available databases, information in the press, a review of literature and input received from stakeholders. All reported cases have been anonymised in order to collate information, identify corruption patterns and allow for frank and open exchanges among participants in the Dialogue.

This report complements the work on Illicit Financial Flows (IFFs) and Oil Commodity Trading, developed under the auspices of the Anti-Corruption Task Team (ACTT), a subsidiary body of the OECD's Development Assistance Committee (DAC). The ACTT programme of work highlights what OECD members can do to mitigate IFF risks in the sector through their role as official development assistance (ODA) providers.

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The report benefited from input during discussions on early drafts of the document at the Twelfth Plenary Meeting of the Policy Dialogue on Natural Resource-based Development (20 June 2019) and the Fifteenth Plenary Meeting (4 December 2020), as well as additional discussions that took place at the Fourteenth Plenary Meeting (26 June 2020).

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Executive summary

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 and gas sales from national oil companies (NOCs) to buying companies, showed that sales from 35 NOCs generated over USD 1.5 trillion in 2016, which equalled 22% of those countries' total government revenues (Malden and Williams, 2019[3]). As a result, many developing countries are heavily dependent on revenues from the sale of publicly-owned commodities. For example, revenues from the sales of publicly-owned oil and gas account for more than two thirds of total government revenues in Azerbaijan, Iraq, Nigeria and the Republic of the Congo (UNCTAD, 2020[4]) and more than half of total government revenues in Libya (Sayne and Gillies, 2016[5]). Similarly, in the mining sector, sales of minerals can make important economic contributions to developing countries. Research from the International Institute for Sustainable Development (IISD) found that global exports of mineral and metal commodities had a total value of USD 732 billion in 2013 (Löf and Ericsson, 2019[6]).

Commodity trading presents specific and heightened risks of corruption as even a minor embezzlement may divert substantial amounts of resources (Longchamp and Perrot, 2017[7]). The sophisticated mechanisms often used to channel corrupt payments add to this risk. These 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).

Commodity sales often involve different jurisdictions through which transactions are routed, ranging from producing countries, through offshore financial centres to trading hubs and countries of destination. Home jurisdictions of buying companies, trading hubs, offshore financial centres, host governments and state-owned enterprises (SOEs), and buying companies all have a role to play in addressing corruption risks in transactions, including through enhanced disclosure of payments made for the purchase of publicly-owned commodities. These actors should ensure that the scope of commodity trading payment disclosures reflects the full spectrum of the corruption risks identified in this report, so that enhanced transparency translates into improved accountability.

In particular, as a significant share of global commodity trading transactions takes place in a number of major global trading hubs, those hubs should take active steps, including through corporate payment disclosure requirements, 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.

1 Corruption risks across commodity trading transactions: An overview

Corruption risks arise at different steps of a commodity trading transaction. From the initial process of selecting a buyer, to the negotiation of the terms of the sales contract, the shipment or transfer of the commodities, through to the process by which the payment is made (Figure 1.1).

Figure 1.1. Commodity trading transactions: 4 segments where corruption risks may arise



The next four sections of this paper analyse the risks at each of these four steps in detail. Prior to that, this section analyses more corruption risks arising *across* these four steps (Box 1.1). They primarily refer to the opacity of ownership and governance structures of key actors involved in commodity trading (including the use of corporate vehicles, the concealment of beneficial owners, and the involvement of PEPs), as well as a lack of or insufficient corporate due-diligence on behalf of commodity trading companies.

Box 1.1. Red flags of corruption risks of cross-cutting relevance across commodity trading transactions

- Opacity of ownership and governance structures of key actors involved in commodity trading;
- Use of fragmented corporate vehicles in commodity trading transactions;
- Use of front companies to purchase commodities;
- Use of joint venture structures in commodity trading transactions;
- Concealment of beneficial owners of buyers;
- Involvement of politically exposed persons in commodity trading transactions;
- Use of intermediaries in commodity trading transactions; and
- A lack of or insufficient corporate due diligence.

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

Recent research by the OECD into IFFs in oil and gas commodity trading demonstrated that buying companies are heavy users of offshore financial centres, and consist of groups of subsidiaries numbering in the hundreds, and in few cases, in the thousands, operating across multiple jurisdictions (Nesvetailova et al., 2021[8]).

These structures may be observed for example in the case of state-owned enterprises (SOEs) that create subsidiaries for commodity trading activities in purchaser and consumer countries; or in the case of buying companies using multiple entities with holdings and subsidiaries registered in different jurisdictions, and front companies to conceal ultimate beneficial ownership (OECD, 2016[1]).

In terms of SOEs selling publicly-owned commodities, it is quite common in the business of oil trading to see national oil companies (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[1]).

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[7]). Recent research by the OECD into the corporate structures of six SOEs further demonstrated the opacity of publicly available information. Consolidated accounts were only available for one SOE and audited accounts could not be located for any of the SOEs in the sample. Some complex corporate structures could be identified – for example one SOE has 108 separate subsidiaries, 14 of which are controlled through a company registered in an offshore financial centre (Nesvetailova et al., 2021[8]).

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.

These buying companies may be both public and private, and form part of a wider corporate structure with multiple entities with holdings and subsidiaries registered in different jurisdictions, and where the

accounting, ownership and equity structures may be fragmented. This can render transactions more opaque and money flows more difficult to track (Nesvetailova et al., 2021[8]). 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[1]).

Use of corporate vehicles in commodity trading transactions

Buying 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 buying companies, and reduce transparency and oversight surrounding commodity trading transactions.

Corporate vehicles refer to entities that conduct a wide variety of commercial and entrepreneurial activities. These 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]).

Excessive complexity in a corporate vehicle structure, the use of opaque accounting practices and a high prevalence of the use of offshore financial centres may constitute red flags of corruption risks. Many of the "independent" commodity trading companies are heavy users of offshore financial centres (OFCs) for their holding companies, regional holdings and special purpose vehicles (Anderson and Porter, forthcoming[10]).

The frequent use of OFC for the registration or domiciliation of subsidiaries by buying companies can also impact the degree of transparency around the accounting practices of those companies. ***For example***, recent research by the OECD notes the prevalence of buying companies centralising and pooling value among different entities within the corporate group, mixing trading, treasury operations, as well as the presence of internal shadow bank functions. In addition, a pattern of a "fixed operating margin" (FOM) was identified where nearly all revenues are matched by a commensurate rise or decline in expenses on a yearly basis, as well as the existence of a significant number of dormant corporate vehicles – which appear to have no operational functions but may be used to accumulate profits on capital acquired in other jurisdictions (Nesvetailova et al., 2021[8]).

For example, in May 2017, the Office of the Attorney General of Switzerland initiated legal proceedings into a large buying company concerning pre-payments made by that company to a SOE in a resource-rich country to secure shipments of crude oil. The scheme involving several employees of the buying company as well as its financial services department paid large commissions to intermediaries (including a PEP) to secure the contract (Public Eye, 2018[11]). The buying company's shadow bank functions played a key role in this corruption scheme where operations and transfers among different legal persons, both internal and external, produce a fragmentation of compliance and oversight that creates opportunities for corruption (Anderson and Porter, forthcoming[10]).

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**. ***For example***, the New York District Attorney's Office charged a major buying company, registered in a major trade hub, for its involvement in a scheme to pay kickbacks to government representatives in connection with the purchase of oil. The buying company used an associated entity to send the kickbacks to accounts controlled by the government representatives (TRACE International, Inc., 2020[12]).

In another example, a major buying company, registered in a trading hub entered into a deferred prosecution agreement in December 2020 with the United States Justice Department to resolve investigations into violations of the Foreign Corrupt Practices Act (FCPA). This included setting up schemes to pay bribes to numerous public officials in three resource-rich countries. The schemes were

concealed through the use of intermediaries and a fictitious company that facilitated the payments to offshore accounts and, ultimately, to the corrupted officials. Furthermore, the buying company entered into sham consulting agreements, set up shell companies, created fake invoices for purported consulting services and used alias email accounts to transfer funds to offshore companies involved in the conspiracy. Under the terms of the deferred prosecution agreement, the buying company was required to pay a total criminal penalty of USD 135 million (United States Department of Justice, 2020[13]).

Use of front companies to purchase commodities

Buying 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.

The OECD Development Centre's 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[1]).

Buying 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[7]).

For example, a large buying 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 buying 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[14]).

In another example, a large buying 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 buying 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 buying company (Volcker, Goldstone and Pieth, 2005[15]).

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

Joint ventures are a flexible form of corporate identity that two or more parties can use in order to execute a business undertaking (Box 1.2). 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 1.2. 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, 2009[16]).

Buying companies may form joint ventures with other entities to reduce commercial risk, to comply with local content requirements of a particular jurisdiction, or to increase its chances of being awarded a sales contract. In some cases, **commodity trading companies may establish joint ventures with PEPs in resource-rich countries**, which may be used in order to access local commodity markets.

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 to its association with the PEP. This may include the undervaluation of commodities for export, which itself may be symptomatic of a corruption scheme where a commodity is undervalued to allow the initial buyer to purchase the commodity at a low price before quickly off-selling the commodity at a market price on the international market (OECD, 2016[1]), Joint venture structures can then be used to distribute dividends to participants on the basis of their share in the joint venture, allowing both the buying companies and PEP to benefit from the sales transaction. Joint venture structures can act to obscure the identities of the beneficial owners and the involvement of the PEPs.

For example, a large buying 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 buying 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 was complex and involved numerous subsidiaries registered across many different 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[17]).

Buying companies may use joint ventures structures to insert distance between them 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[16]).

In other scenarios, buyers may enter into joint ventures with SOEs or their subsidiaries. These joint ventures can create conflicting incentives for the SOE which finds itself on both sides of the transactions, and these blurring of roles may open the door to corruption and public rent diversion.

For example, an SOE from a major resource-rich developing country set up a joint venture entity in a Caribbean jurisdiction with a large buying company, from a major trading hub. Once this corporate structure was in place, the SOE 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[18]).

Concealment of beneficial owners of buyers

Both buyers and sellers can use corporate vehicles 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[4]).

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. The Financial Action Task Force's (FATF) definition of beneficial ownership (Box 1.3) has been adopted by the OECD-hosted Global Forum on Transparency and Exchange of Information for Tax Purposes in 2016, and represents the most widely established international standard for ensuring the availability of beneficial ownership information (OECD and IADB, 2019[19]).

Box 1.3. Financial Action Task Force: 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[20]).

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[21]). Beneficial ownership information can be obscured through the use of:

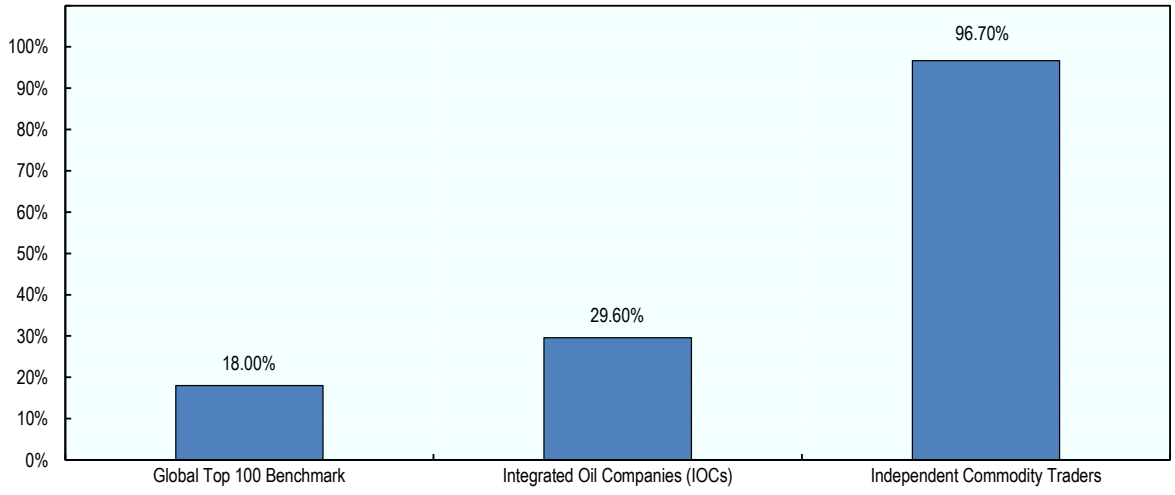
- shell companies[1] (which can be established with various forms of ownership structure) especially in cases where there is foreign ownership which is spread across jurisdictions;
- complex ownership and control structures involving many layers of shares registered in the name of other legal persons;
- 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 (FATF, 2014[9]).

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[22]). 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 (Hector, H., 2014[23]).

More recent research by the OECD into IFFs in oil and gas commodity trading demonstrated that **buying companies are heavy users of offshore financial centres to structure their operations** and to refigure their subsidiaries (Figure 1.2). An analysis of the equity structure of the top 100 global industrial firms by revenue in 2018 showed that the average proportion of group subsidiaries owned via an OFC-based intermediated holding company was 18%. In comparison, an analysis of the equity structure of the "independent" commodity trading companies reveals a figure of 96.7% (Nesvetailova et al., 2021[8]).

Figure 1.2. Percentage of subsidiaries controlled by holding companies registered in offshore financial centres



Source: (Nesvetailova et al., 2021[8]).

The prevalence of the use of offshore financial centres and secrecy jurisdictions by commodity trading companies to incorporate subsidiaries and carry out operational activities increases the risks of corruption in commodity trading transactions. Beneficial ownership information is more difficult to obtain from entities registered in these jurisdictions, and this can frustrate investigations and attempts to monitor the sector by regulators, including the Extractive Industries Transparency Initiative (EITI) (Nesvetailova et al., 2021[8]).

Involvement of politically exposed persons in commodity trading transactions

PEPs may use complex corporate and legal structures, including intermediaries, briefcase or shell companies, or joint ventures with buying companies, in order to participate in commodity sale transactions. 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.

The FATF definition of a PEP refers to a natural person who has been entrusted with prominent public functions (Box 1.4). This may include senior members of the government or other such senior officials in the administration, judiciary, police, military or employees of SOEs.

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

Box 1.4. Financial Action Task Force: Definition of politically exposed persons

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[20]).

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[24]).

Several cases have been documented where buying 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[11]).

For example, a buying 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.

In another example, a buying 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 buying 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 buying company was able to secure oil shipments in excess of USD 3 billion (Public Eye, 2018[11]).

Use of intermediaries in commodity trading transactions

The use of intermediaries by buying companies to facilitate the sale and purchase of commodities trading transactions has been recognised by various investigative agencies, international organisations and civil society organisations.

Buyers may engage the services of an intermediary to help facilitate a commodity sales transaction. Box 1.5 sets out the OECD's definition of an intermediary, who can be a legal or a natural person. An intermediary may help facilitate the transaction between the buyer (trader) and the seller (government) or may him/herself act as the buyer in the transaction before quickly off-selling the commodity to the trader.

Box 1.5. 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[16]).

The participation 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[25]). 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[26]).

In commodity trading transactions, a common example concerns a corruption scheme where the buyer pays the intermediary a fee for his/her services, and then the intermediary subsequently pays bribes to 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.

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[27]).

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[7]).

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 buying companies. 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[5]).

In another example, a buying 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 buying 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 buying 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[7]).

In other situations, intermediaries may be natural persons who help facilitate transactions between buyers (buying companies) and sellers (SOEs). ***In one example***, an intermediary acting as an agent for a large buying 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[28]).

In another example, the Office of the Attorney General of Switzerland held a buying company criminally liable for failing to take 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 buying 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 specifically highlight the increased risk of corruption associated with agents' activities. The buying company was ordered to pay the sum of CHF 94 million (Office of the Attorney General of Switzerland, 2019[29]).

In another example, a subsidiary of a different buying 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[28]).

Lack of or insufficient corporate due diligence

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[1]).

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.

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, Inc., 2020[12]).

Buying 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[30]).

Trading hubs and home jurisdictions of buying companies can contribute to mitigating the risk of a lack of due diligence and compliance procedures by passing legislation to require buying

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[1]).

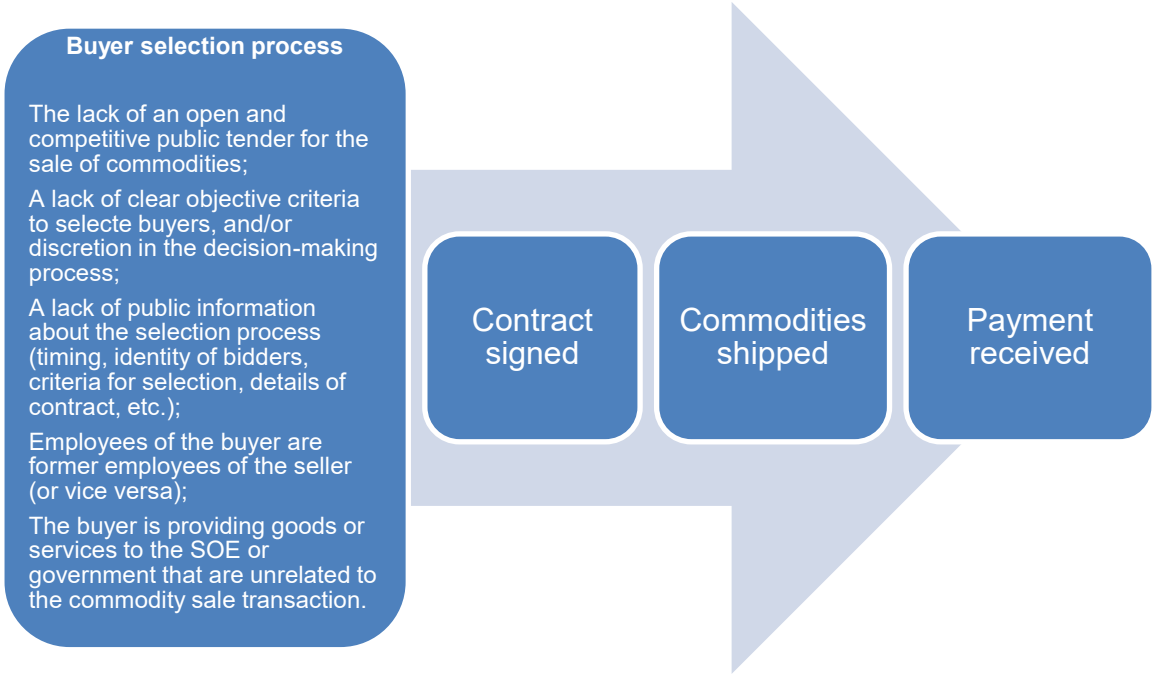
Note

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

2 Corruption risks in the buyer selection process

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 interaction of the buying companies with state authorities (Longchamp and Perrot, 2017[7]). These risks include the opacity of the selection of buyers, the use of bribery to secure commodities, and the existence of conflicts of interest between buyer and seller. Figure 2.1 sets out a number of red flags that may indicate the presence of corruption in the buyer selection process.

Figure 2.1. Red flags of corruption risks that can arise during the buyer selection process



Opacity of the selection of buyers

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.

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. This may occur in particular where a buying 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[1]).

Additional risks may arise in situations where commodities are sold through a competitive bidding process, where bidders may 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 (OECD, 2020[31]). 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.

The allocation process for selecting buyers of publicly-owned commodities is often opaque. ***For example***, 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[7]).

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[11]).

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 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[1]). 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 those criteria.

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 1 and 3.

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[32]). Furthermore, the contract contained numerous clauses that directly harmed the public finances of that oil exporting country (Public Eye, 2018[11]).

In another example, a buying company based in a major commodity trading hub made payments to two shell companies controlled by a trader and a former adviser to a president of a resource-rich country. The trader and adviser reportedly secured meetings between employees of the buying company and senior government officials in another resource-rich country, including the president. Following those meetings, the buying company was selected to purchase several million barrels of crude oil from the NOC (Sayne and Gillies, 2016[5]).

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. 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.

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 Development Centre, 2019[33]).

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

Use of bribery to secure commodities

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[32]).

Bribery mechanisms include kickbacks, secret commissions, and facilitation payments. ***For example***, prospective buyers may pay direct commissions to a public official 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.

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 – see also (Anderson and Porter, forthcoming[10]). These financial flows and the front company may be part of a larger and complex corporate structure that makes the identification of the key individuals involved very difficult (Longchamp and Perrot, 2017[7]).

In another example, a buying 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, Inc., 2020[12]).

Existence of conflicts of interest between buyer and seller

Conflicts of interest in both the public and private sector have become a major matter of public concern worldwide, and these have been documented by the OECD (Box 2.1). 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 2.1. 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 his/her official duties and responsibilities.

Source: (OECD, 2003[34]).

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.**

For example, 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[35]).

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.

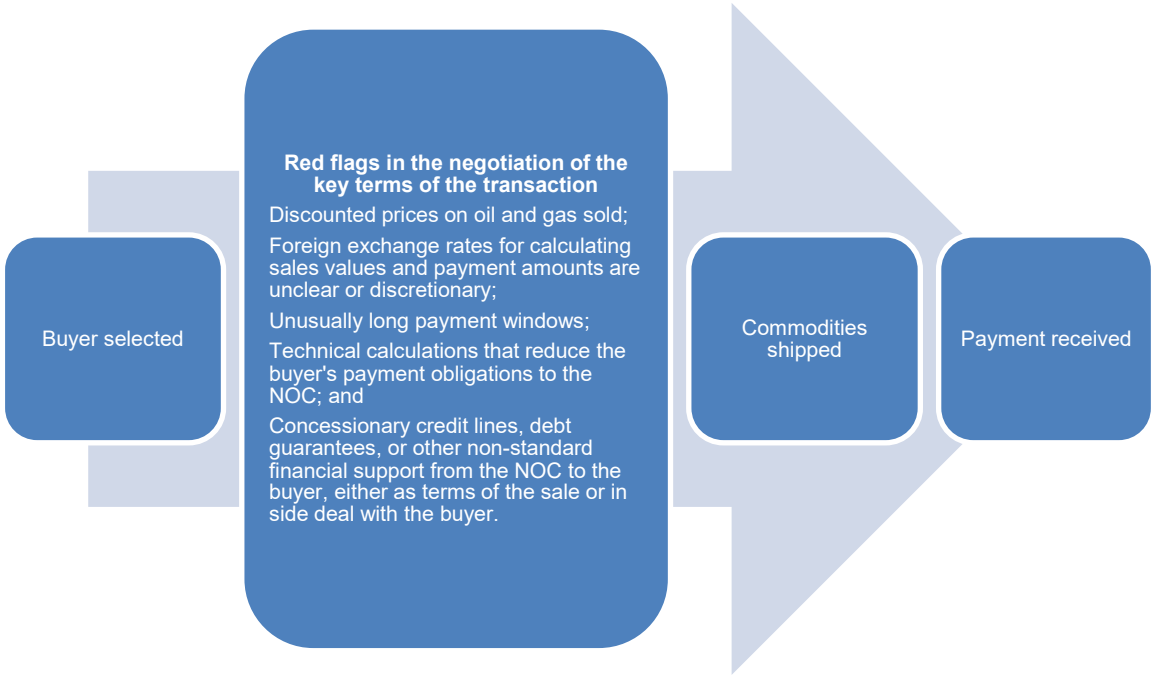
Recommendations for mitigating risks associated with conflicts of interest are set out in the OECD Development Centre's guidance for SOEs on the selection of buyers of oil, gas and minerals (OECD, 2020[31]). SOEs should require buyers to disclose any conflict of interest but should also undertake their 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").

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.

3 Corruption risks in the terms of the sales agreement

A lack of transparency of the terms of commodity sales agreements can provide opportunities for corruption. These risks can arise in respect of the key terms of the agreement (for example, volume or price), and additional risks may arise with the use of non-conventional sales agreements. Figure 3.1 sets out a number of red flags that may indicate the presence of corruption in the negotiation of the key terms of the transaction.

Figure 3.1. Red flags of corruption risks that can arise in the negotiation of terms of a sales agreement



Source: Adapted from (Sayne and Gillies, 2016[5]).

Lack of transparency of the key terms of the transaction

Not all "bad deals" are direct results 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[32]). 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.

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.

Corruption risks may arise in the jurisdictions where buying 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[1]).

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 buying 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 to the civil society sources, the terms of the transaction gave the parties discretion to choose exchange rates for foreign currency conversions and provided the buying 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 buying company to post any security for the refined products it received (Sayne and Gillies, 2016[5]).

For example, the OECD Corruption Typology reports the case of suspicious transactions where a small buying 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[1]).

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

Resource-backed finance agreements

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).

In sub-Saharan Africa, resource-backed finance agreements were first 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. These agreements are ordinarily entered into by governments or by SOEs themselves, whereas the lenders are often state-owned development banks from China and independent commodity trading companies (Mihalyi, Adam and Hwang, 2020[36]). A growing volume and share of sub-Saharan African government debt is now owed to commercial creditors (25%), compared to multilateral (38%), Paris Club bilateral (7%) and non-Paris Club bilateral (30%) lenders (Anderson and Porter, forthcoming[10]).

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[36]).

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. Furthermore, these loans may be made available outside of the government's regular budgetary process (Mihalyi, Adam and Hwang, 2020[36]) which can add to the risk of misappropriation or diversion of public revenues under a resource-backed finance agreements (Global Witness, 2019[37]).

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. Buying companies generally only make substantial disclosures when repayment problems emerge, and a lack of transparency around resource-backed loans can make renegotiation more difficult (OECD, 2020[38]). For example, one major buying 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[36]). In other cases, information about the existence or the terms of resource-backed finance arrangements may become available when a country enters a period of debt distress.

Of the 52 loans evaluated by the NRGI in 2020, the full loan agreement was only publicly available in 1 out of the 52 cases. This agreement was only made public 12 years after it was signed, and five years since the related copper and cobalt mining started. There is no comprehensive information available about the associated infrastructure funding or the repayment plan. Furthermore, two thirds of those loans went to countries with a poor or failing score under the NRGIs Resource Governance Index.

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 buying 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 buying 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[36]). Financial institutions were present in this transaction as lenders to the buying company. Two loans were granted by the buying company to the SOE from its own funds, and a further four loans were originally lent by financial institutions to the buying with the understanding that they would be on-loaned to the SOE. However, these banks did not report any suspicions to regulatory authorities until after the Office of the Attorney General of Switzerland had begun its investigation into these transactions (Public Eye, 2017[39]).

Commodity-for-product-swap-agreements

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.

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[1]).

For example, a SOE from a resource-rich developing country entered into several commodity-for-product-swap-agreements with buying companies. Official justified these need for these agreements to alleviate

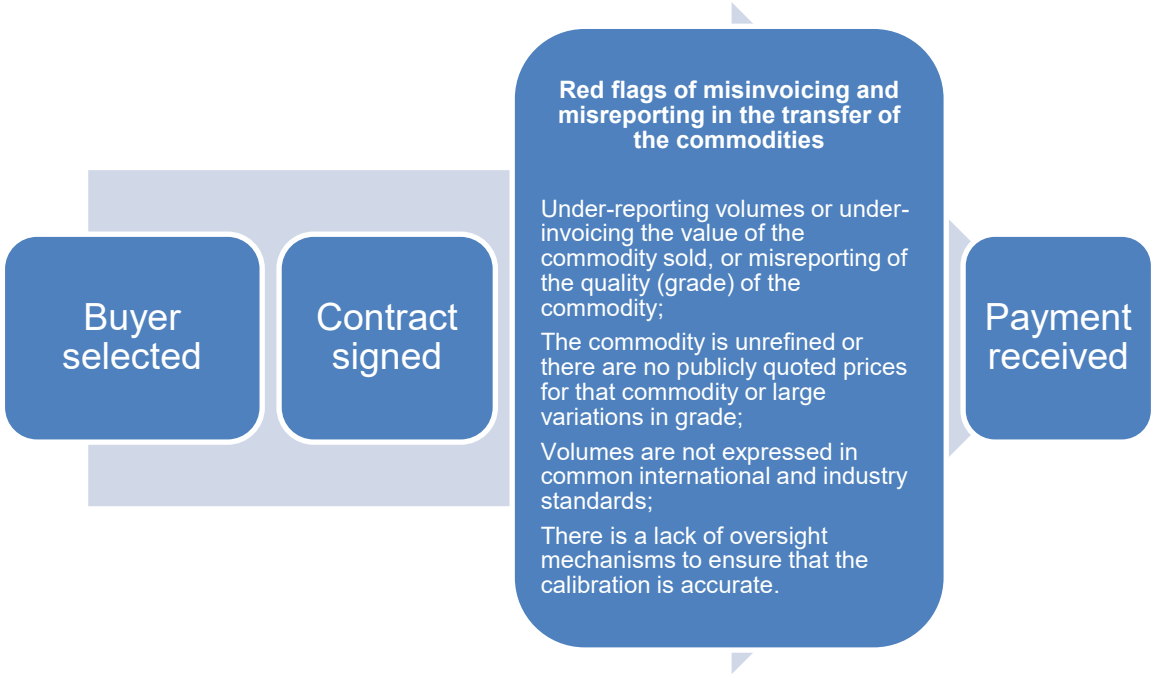
domestic fuel shortages. The agreements consumed roughly a fifth of the government's share of oil production, a portion worth an estimated USD 35 billion in 2010 to 2014 (Sayne and Gillies, 2016[5]).

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 buying companies to profit at the expense of the SOE. It was estimated that losses from a single contract could have reached USD 381 million in one year. While there is no direct evidence of corruption, it was observed that some of the buying companies selected lacked fundamental trading capabilities, including the ability to market their own crude and source fuel directly from refiners. These companies were chosen over more experienced buying 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[5]).

4 Corruption risks in the transfer of the commodities

Opacity in the transfer of commodities can provide opportunities for corruption, for example, in the misinvoicing of commodities, the misreporting of grade and valuation or the misreporting of volume. Figure 4.1 sets out a number of red flags that may indicate the presence of corruption in the transfer of commodities.

Figure 4.1. Red flags of corruption risks that can arise in the transfer of the commodities



Misinvoicing of commodities

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 a 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[1]).

The manipulation or abuse of the payment date can also represent a corruption risk. These risks 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[1]).

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[40]).

However, 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 represents a benefit for the buyer, this benefit may be reflected in the selling price for the commodity sale.

Misreporting of grade and valuation

The OECD has noted the opportunities for corruption that may occur in respect of the reporting or classification of minerals in the upstream mineral supply chain. Increased attention should be paid to circumstances of vulnerability, such as where public officials have a history or reputation of requesting bribes to fraudulently provide documentation related to due diligence certification, transport and export, valuation of minerals, misreporting or misclassification of minerals (OECD, 2021[41]).

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[42]). Table 4.1 sets out the risk of undervaluation for different minerals and metals.

Table 4.1. Risk of undervaluation for minerals and metals

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

Source: (IISD/OECD, 2018[42]).

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

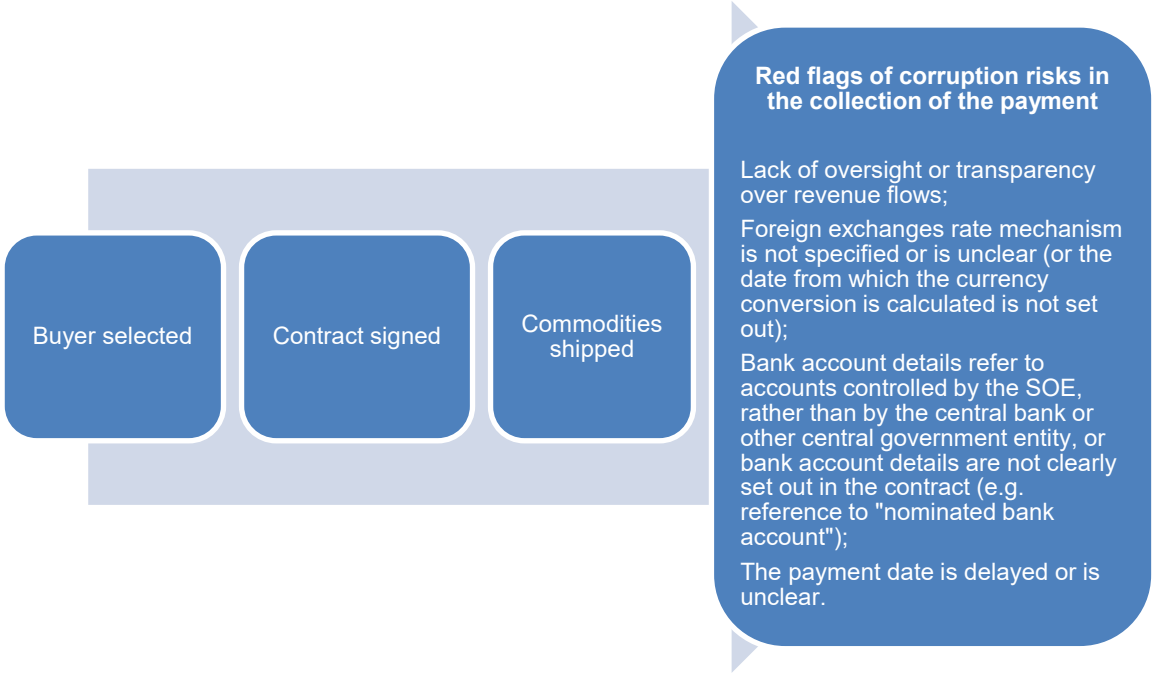
It is important to ensure that volumes are not over- or underreported so that any value is not lost in a commodity transaction. There are several international and industry standards for expressing commodity volumes (bbl., MMBtu, tonnes, troy ounces, etc.) that should be routinely used to reduce opacity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

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.

5 Corruption risks in the collection of the payment

A lack of transparency surrounding the collection of the payment provides opportunities for corruption. These risks may arise in respect of the opacity of the revenue flows, manipulation of the foreign exchange rate, or a lack of transparency of the payment account. Figure 5.1 sets out a number of red flags that may indicate the presence of corruption in the collection of the payment.

Figure 5.1. Red flags of corruption risks that can arise in the collection of the payment



Opacity of the revenue flows

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.

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

For example, 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 PEPs) or contributing to the creation of complex and opaque structures of corporate vehicles rendering the identification of beneficial owners more difficult (OECD, 2016[1]).

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[5]).

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[5]).

In 2016, an analysis by the NRGI of 33 NOCs showed that just 22% of combined total revenue they generated, including from oil sales, was directed to their countries' national treasuries (Malden and Williams, 2019[3]).

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[7]). Trading hubs and home jurisdictions of buying companies 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[1]).

Manipulation of the foreign exchange rate

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

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 due to the often significant value of a given commodity sale transaction. 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 the wording is vague.

For example, in 2015, an investigation into commodity trading transaction identified a contract between the state-owned oil refinery and a buying 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[43]).

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[40]).

Lack of transparency of the payment account

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.

It is important that bank 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[40]).

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[1]).

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), which 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[5]).

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% of government spending (Sayne and Gillies, 2016[5]).

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Annex A. OECD initiatives on corruption in commodity trading

The OECD hosts a number of initiatives focusing on illicit financial flows and corruption in the commodity trading sector. For ease of reference, the outputs of those initiatives are listed below.

Thematic Dialogue on Commodity Trading Transparency

Hosted by the OECD Development Centre, the Thematic Dialogue on Commodity Trading Transparency was launched in response to the call made at the London 2016 Anti-Corruption Summit to provide a multi-stakeholder dialogue platform for collaboration on how the global and multifaceted challenges of corruption in commodity trading can be addressed from both the supply and demand sides. The outputs of the Thematic Dialogue (listed below) provide complementary and mutually supportive tools that home countries, trading hubs, trading companies and producing countries, including state-owned enterprises, can use to reduce drivers of corruption, increase transparency and achieve improved accountability in commodity trading.

- OECD (2020), *How to Select Buyers of Oil, Gas and Minerals: Guidance for State-Owned Enterprises*, OECD Development Policy Tools, OECD Publishing, Paris, https://doi.org/10.1787/a522e6c0-en.
- OECD (2021), *Typology of Corruption Risks in Commodity Trading Transactions*, OECD Development Policy Tools, OECD Publishing, Paris, https://doi.org/10.1787/590e80e8-en.
- OECD (2021), *Options for Operationalising Transparency in Commodity Trading*, OECD Development Policy Tools, OECD Publishing, Paris, https://doi.org/10.1787/70007e06-en.
- "Online Mapping Tool of State-Owned Enterprises and Their Subsidiaries" (2021), https://www.oecd.org/dev/online-mapping-tool-state-owned-enterprises-their-subsidiaries.htm.
- "Online Stocktake of Company Reporting Requirements Applicable in Different Trading Hubs" (2021), https://www.oecd.org/dev/company-reporting-requirements-different-trading-hubs-stocktake.htm.

Illicit Financial Flows in Oil and Gas Commodity Trading

Led by the Anti-Corruption Task Team (ACTT), a subsidiary body of the OECD's Development Assistance Committee (DAC), the OECD-DAC's Programme of Work on Illicit Financial Flows in Oil Commodity Trading is undertaken in dialogue with oil producing African economies, and aligns with the OECD's high priority afforded to tackling IFFs. Focusing on the vulnerabilities to IFFs that arise in the oil sales process, the OECD-DAC Programme of Work highlights what OECD members and partners can do to mitigate IFF risks in the commodity trading sector, including through official development assistance (ODA) and in their role as the home or host of the range of markets and enablers that may raise or exacerbate IFF risks.

- Anderson, C. (forthcoming), "Review of complementary ODA engagement efforts in reducing IFFs in oil trade activities and identification of potential points for ODA intervention", *OECD IFFs and Oil Trading Programme Working Paper*, OECD Publishing, Paris.
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OECD Development Policy Tools

Typology of Corruption Risks in Commodity Trading Transactions

Commodity trading presents specific and heightened risks of corruption due to the large amount of money involved in commodity trading transactions, which are source of important revenues for developing countries, and due to the sophisticated mechanisms used to channel corrupt payments. These include complex and opaque corporate structures, the use of off-shore entities, that render the identification of beneficial owners more difficult, the use of intermediaries (including briefcase or shell companies) and joint ventures with politically exposed persons (PEPs).

This report maps out corruption risks of cross-cutting relevance for the sales of oil, gas and minerals that can arise at several points in commodity trading transactions. It contributes to advancing the global transparency and accountability agenda in commodity trading, by improving understanding and raising awareness of corruption red flags and evolving corruption patterns across a wide range of stakeholders, including home jurisdictions of buying companies, trading hubs, host governments, state-owned enterprises and buying companies.

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