

Annex C: Proposed changes to Requirement 4.2 on commodity trading

For decision

For discussion

For information

Summary

This paper seeks to briefly summarise the overall objective of EITI's work on commodity trading transparency and provide concrete recommendations for improvements to the EITI Requirement, drawing on the lessons learned from disclosure practices over the past three years.

Some of the proposed changes are pending further input from the commodity trading working group and are being shared with the Implementation Committee for information.

Proposed changes to Requirement 4.2 on commodity trading

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1 Background

Ensuring transparency in how the state’s share of oil, gas and minerals production is monetised goes to the core of the EITI’s mandate. EITI’s first principle is that “the prudent use of natural resource wealth should be an important engine for sustainable economic growth that contributes to sustainable development and poverty reduction”.¹ Half of the revenues collected by EITI countries are received in-kind, amounting to over USD 1 trillion of revenues disclosed as part of EITI reporting. There are at least 17 EITI countries that collect a share of their revenues in kind, and for many of these countries these are the main transactions that are significant for understanding the government share of revenues from the sector.² It is therefore natural that the EITI’s core concern is transparency in how a country’s extractive sector revenues are used to benefit its population through the government budget. Once the state receives its share of oil, gas or minerals production, trading is how these commodities are converted into funds that reach the government treasury.

Amidst growing calls for greater transparency and accountability in oil trading, the EITI has emerged as a practical, flexible and cost-effective response. A key feature of the EITI is that it is owned and implemented by producer countries, emphasising collaboration between government, industry and civil society organisations. This collaboration has also taken place at the global level through a working group with leading governments, state-owned enterprises, commodity traders and civil society.³ The working group has developed reporting guidance and tools that have been implemented by governments, state-owned enterprises (SOEs) and commodity traders alike. At the national level, EITI multi-stakeholder groups have used the guidance to improve reporting and inform discussions related to the return on the sale of their natural resources.⁴ The work so far includes more granular and detailed disclosures in at least eight EITI implementing countries,⁵ allowing stakeholders to understand and explore the way in which these sales are conducted.⁶

It is widely accepted that much more work is needed to improve transparency and accountability in global commodity trading. While disclosure requirements in the home jurisdictions of trading companies may

¹ EITI Principle 1: <https://eiti.org/document/eiti-principles>

² Most of these countries collect oil in kind, while some collect gas and very few collect minerals in kind.

³ See Board Paper 34-4-B Annex B: TOR for the working group on transparency in commodity trading

⁴ See Board Paper 41-4-B Annex A: Country by country overview of progress

⁵ Albania, Cameroon, Chad, Cote d’Ivoire, Ghana, Indonesia, Mauritania and Nigeria.

⁶ EITI Commodity trading transparency stocktake: <https://eiti.org/document/commodity-trading-transparency-stocktake>

contribute, the EITI's work on the first trades by SOEs in producer countries is essential. The targeted effort on commodity trading transparency⁷ has identified emerging disclosure practices and contributed with various lessons learned⁸ that the EITI Board is now seeking to reflect in an updated version of the EITI Standard.⁹

2 Proposed changes to Requirement 4.2

Based on the emerging practices and lessons learned from the targeted efforts on commodity trading transparency, the EITI International is seeking comments on the following proposed language:

4.2 Sale of the state's share of production or other revenues collected in kind.

a) Where the sale of the state's share of production of oil, gas and/or mineral resources or other revenues collected in kind is material, the government, including state-owned enterprises, are required to disclose the volumes received and sold by the state (or third parties appointed by the state to sell on their behalf), the revenues received from the sale, and the revenues transferred to the state from the proceeds of oil, gas and minerals sold. ~~disclose the revenues received~~ This could include payments related to swap agreements and resource-backed loans.

The published data must be disaggregated by individual buying company

["and to levels commensurate with the reporting of other payments and revenue streams (4.7). Reporting could also break down disclosures by the type of product, market, sale volume, price individual contract or individual sale (i.e. cargo or shipment)"] OR *["and to levels commensurate with the reporting of other payments and revenue streams (4.7). and individual sale (i.e. cargo or shipment) and could be further disaggregated by the type of product or price, market, sale volume"]*.

The disclosures could for each sale include ownership of the of product sold, the nature of the contract (e.g. spot or term), pricing options and realised prices.

b) Implementing countries including state-owned enterprises are encouraged to disclose a description of the process for selecting the buying companies, the technical and financial criteria used to make the selection, the list of selected buying companies, any material deviations from the applicable legal and regulatory framework governing the selection of buying companies, and the related sales agreements.

c) Companies buying oil, gas and minerals from the state, including state-owned enterprises (or third parties appointed by the state to sell on their behalf), are encouraged to disclose volumes received from the state or state-owned enterprise, payments made for the purchase of oil, gas and solid minerals and value of the product delivered at time of purchase. This could include payments related to swap agreements and resource-backed loans.

The published data could be disaggregated by individual seller, contract, price or sale.

The disclosures could for each sale include information on the nature of the contract (e.g. spot or term), pricing options, realised prices and load port.

d) Where there are concerns related to data reliability and where practically feasible, the multi-stakeholder group should consider further efforts to address any gaps, inconsistencies and irregularities in the

⁷ Terms of Reference for a targeted effort on transparency in commodity trading: <https://eiti.org/document/tor-for-targeted-effort-on-transparency-in-commodity-trading>

⁸ See Board Paper 41-4-B Annex B: Commodity trading issues: Outcome of consultation

⁹ BD 41-4-B, BD 41-4-C.

~~information disclosed. is encouraged to task the Independent Administrator with reconciling the volumes sold and revenues received by including the buying companies in the reporting process.~~

3 Issues to be clarified through further work and guidance

The following points were raised during the consultation as areas the EITI and the working group should clarify in the updated version of the guidance note and further work in 2019:

- **Equity oil:** For Validation purposes, the “state’s share of production or other revenues collected in kind” refers to the sale of the state’s share of production and in-kind revenues collected by government, including state-owned enterprises, when acting as fiscal agents. The guidance note should be updated to reflect the varying roles SOE have in marketing the state’s share of oil, gas and minerals. MSGs could also be encouraged to document whether SOEs collect equity oil and comment on the extent to which information on equity oil sales is publicly available. In cases where data on equity oil sales are not publicly available, the MSG could be encouraged to consider making recommendations on how such information could be disclosed, including addressing any legal or practical barriers preventing such comprehensive disclosure. The Validation Guide would be updated to ensure that Validation documents the MSG’s discussion on these issues.
- **State-owned refineries:** According to EITI Requirement 4.2, state-owned domestic refineries that buy state owned oil, gas and minerals are considered buyers. Government agencies or SOEs selling the state’s share of oil to state-owned domestic refineries should disclose the volumes sold and revenues received, in accordance with Requirement 4.2. The disclosures could further distinguish between the values of the oil, gas or minerals delivered and the equivalent payments to the state.
- **Sales to other government entities:** Implementing countries and SOEs could be encouraged to disclose information beyond volumes sold and values received from the “first trade” in cases where the oil, gas or minerals are sold to other government entities. In cases where oil, gas or minerals are used to control price or ensuring domestic supply, the policy and actual practice could be explained.
- **Further guidance on gas and minerals sales:** Working group members have highlighted the need to ensure that guidance is provided on how to apply the requirement to gas sales, in response to demand from target effort countries like Ghana to look further into the gas sector. How to disclose information on mineral sales, in particular from the point of view of buyers, has also been raised. The working group should tailor the guidance and reporting template to address gas sales and bring in stakeholders from the minerals trading industry to help guide EITI’s work in this area.

4 Rationale behind the proposed changes

The EITI Secretariat has compiled the following list of proposed recommendations for the working group’s consideration for how to clarify Requirement 4.2 and reflect the lessons learned from the targeted efforts over the past three years. These recommendations should reflect the different country contexts and the broad spectrum of roles SOEs play in managing the state’s share of production depending on the SOE, the level of state ownership and the legal and fiscal regimes.

It is important to note that most of the recommendations relate to *encouraging* disclosures beyond the minimum requirements. The progress made by implementing countries in disclosing information encouraged by the EITI Standard will be examined during EITI Validation, without consequences for the

overall assessment of progress (unless it is to demonstrate that a country has gone ‘beyond’ the minimum requirement).

1. Third parties acting on behalf of the state

The outcomes of the consultations with the working group on issues identified in the targeted efforts indicate that there was general support for considering intermediary marketing agencies as sellers for EITI reporting purposes. In light of this, it is recommended that:

*EITI Requirement 4.2 is revised to clarify that implementing countries and SOEs should disclose volumes received and sold by the state or **a third party on behalf of the state**.*

2. Granularity and pricing

The commodity trading transparency stocktake found that sales data is becoming significantly more granular, with a number of countries disclosing sales data either disaggregated by month or by date of sale / cargo.¹⁰ These disclosures would include further information on average sales prices, realised per cargo price, and pricing options/formulas and contract type. To reflect this emerging practice, it is recommended that:

EITI Requirement 4.2 is revised to encourage sales data to also be broken down by individual contract or individual sale, and also include information on type of product sold, nature of the contract types, pricing options and realised prices.

3. Buyer selection process

The commodity trading transparency stocktake found that an increasing number of countries were disclosing information about the buyer selection process.¹¹ To reflect this emerging practice, it is recommended that:

EITI Requirement 4.2 is revised to encourage disclosures on the process for selecting buyers, as encouraged in the EITI Guidance note developed by the working group.

4. Encouraging disclosures by buyers and less emphasis on reconciliation

The Board’s strategy on [encouraging systematic disclosure](#) recognises that the EITI’s focus on *reconciling discrepancies* is sometimes burdensome and ineffective. The Board’s strategy seeks to reorient the EITI’s work toward encouraging systematic disclosures by the government agencies, SOEs and traders. These disclosures should be “subject to credible, independent audit, applying international auditing standards”, and the disclosures “should include an explanation of the underlying audit and assurance procedures that the data has been subject to, with public access to the supporting documentation”.

As with many other issues, it is important that multi-stakeholder groups provide a platform for an open discussion about this work, and that it may be important for multi-stakeholder groups document their agreed approach. To reflect the trend towards systematic disclosures and lessons learned from reconciliation so far, it is recommended that:

EITI Requirement 4.2 is revised to encourage disclosures by buyers and emphasise the underlying audit and assurance procedures rather than encouraging reconciliation.

¹⁰ Albania, Iraq and Mozambique disaggregated sales data by month, while Cameroon, Chad, Ghana and Mauritania disaggregated sales data by date of sale.

¹¹ Albania, Chad, Indonesia, Iraq and Mauritania.

Annex: Comments received and responses by the International Secretariat

| Comment | Response from Secretariat | Suggested change |
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| <p>Scope of the requirement: “a) Where the sale of the state’s share of production of oil, gas and/or mineral resources or other revenues collected in kind is material, the government, including state-owned enterprises, are required to disclose the volumes received and sold by the state (or third parties appointed by the state to sell on their behalf), the revenues received from the sale, and the revenues transferred to the state from the proceeds of oil, gas and minerals sold. disclose the revenues received.”</p> | | |
| It should be made clearer what is covered within the scope of “the state’s share of production” | In line with wider scope of the EITI Standard, the state’s share of production covers oil, gas and/or mineral resources. Additional language has been suggested to make this explicit. | “the state’s share of production of oil, gas and/or mineral resources” |
| The proposal does not sufficiently recognise the different roles SOEs play (including as commercial entities acting for their own account) | In the past, the EITI Board has differentiated between cases where the state/SOE receives proceeds from in-kind payments as an equity holder or receives payments in-kind (e.g., in-kind payments of production share, in-kind payments of royalty, or in-kind payments of taxes). In Validations, Requirement 4.2 has been applied to the latter. This will be made clear in the updated version of guidance note 26. | The paper proposes that the application of requirement 4.2 to the sale of the state’s share of production and in-kind revenues collected by government, including state-owned enterprises, when acting as <i>fiscal agents</i> is clarified in the guidance note and Validation Guide. |
| It is not always clear whether intermediary marketing agents should be defined as sellers or buyers. | The findings from the consultation on applying Requirement 4.2 was that there appeared to be consensus to define marketing agents as sellers on behalf of the state. An updated version of the guidance note could not that MSGs can consider disclosing information on marketing fees. We have received a suggestion for specific revisions to make this clearer. | “sold by the state (or third parties appointed by the state to sell on their behalf)” |
| The language on scope of disclosures outlined for buying companies should be consistent with what is required by implementing countries. It | Additional language has been suggested to make proposed additions to Requirement 4.2.c consistent with proposed additions to 4.2.a, and to make it explicit that cash and in-kind payments related to swap agreements and resource-backed loans fall within the scope of Requirement 4.2. | “This could include payments related to swap agreements and resource-backed loans.” |

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| Comment | Response from Secretariat | Suggested change |
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| should also be made explicit that swap agreements and resource-backed loans are covered by Requirement 4.2. | | |
| Level of disaggregation: The published data must be disaggregated by individual buying company and individual sale (i.e. cargo or shipment), and to levels commensurate with the reporting of other payments and revenue streams (4.7). Reporting could also break down disclosures by the type of product, price, market and sale volume. | | |
| Disaggregation “commensurate with reporting of other revenue streams (4.7)” and reporting by project would for sales data entail reporting by sale or contract. | Different views have been raised on the feasibility of requiring cargo by cargo disclosures. Some industry members noted that they were prepared to report on a cargo-by-cargo basis if asked by implementing countries but were not ready to disclose such information unilaterally. Civil society members highlighted the need for the data to be disaggregated by cargo for it to be possible to analyse. One SOE stated their support for cargo-by-cargo disclosures. | It is suggested to include two options in brackets for further discussion by the working group in the lead up to the EITI Board meeting on 27-28 February: [“and to levels commensurate with the reporting of other payments and revenue streams (4.7). Reporting could also break down disclosures by the type of product, market, sale volume, price individual contract or individual sale (i.e. cargo or shipment).” OR “and to levels commensurate with the reporting of other payments and revenue streams (4.7). and individual sale (i.e. cargo or shipment) and could be further disaggregated by the type of product or price, market, sale volume.”] |
| Level of detail: The disclosures could for each sale include ownership of the product sold, the nature of the contract (e.g. spot or term), pricing options and realised prices. | | |
| It should be made clearer that this provision refers to the detail of information to be disclosed as opposed to level of disaggregation. | The suggestion has been reflected in the proposed language. | “The disclosures could for each sale include” |
| “Type of product” is too vague to allow for a common understanding | The suggestion has been reflected in the proposed language. The section on ‘type of oil’ in Guidance note 26 oil reporting of oil sales should be updated to explain this more clearly, | “ownership of the product sold” |

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| of what this encompasses. | drawing from the findings of the consultation on the application of Requirement 4.2. We have updated the language to make type of ownership more explicit in line with the Guidance note. | |
| Encouraged disclosures on buyer selection process: b) Implementing countries including state-owned enterprises are encouraged to disclose a description of the process for selecting the buying companies, the technical and financial criteria used to make the selection, the list of selected buying companies, any material deviations from the applicable legal and regulatory framework governing the selection of buying companies, and the related sales agreements. | | |
| It was suggested to clarify what is considered “non-trivial” deviations. | This comment has also been raised with regards to similar wording in Requirement 2.2 on allocation of licenses and contracts. “The applicable legal and regulatory framework governing the selection of buying companies” refers to the applicable framework in the implementing country. | “any material deviations from the applicable legal and regulatory framework governing the selection of buying companies” |
| Encouraged disclosures by buyers: c) Companies buying oil, gas and minerals from the state, including state-owned enterprises (or third parties appointed by the state to sell on their behalf), are encouraged to disclose volumes received from the state or state-owned enterprise, payments made for the purchase of oil, gas and solid minerals and value of the product delivered at time of purchase. This could include payments related to swap agreements and resource-backed loans. The published data could be disaggregated by individual seller, contract, price or sale. The disclosures could for each sale include information on the nature of the contract (e.g. spot or term), pricing options, realised prices and load port. | | |
| Disclosures by buyers in line with Requirement 4.2 should be required, rather than encouraged. | Some working group members expressed a desire to rephrase the provision to be “required” in the December meeting. However, members from industry highlighted how requiring such disclosures would require extensive consultations beyond the suggested timeframe for the revisions to Requirement 4.2. This would need to include clarifying how the term “required” would be applied in practice for buying companies. This issue could be considered in the future by the working group and EITI Board once more buyers have started disclosing information in line | It is proposed that working group members endorse language proposed to encourage disclosures by buyers. The working group might wish to consider studying this issue of required vs encouraged applicable to commodity traders further. |

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| | with the encouraged provision of the requirement. | |
| It was indicated that what information should be included as part of “swap agreements and resource-backed loans” was unclear. | Guidance note 26 oil reporting of oil sales (pp. 23-24) provides a suggested framework for disclosing information on swap agreements and resource-backed loans. It should also be noted that this provision is only encouraged. | It is proposed that working group members endorse language proposed to encourage disclosures by buyers. |
| It was suggested to ensure consistency between the level of detail of information encouraged to be disclosed by implementing countries as well as buying companies. | The suggestion has been reflected in the proposed language. | “The disclosures could for each sale include information the nature of the contract (e.g. spot or term), pricing options, realised prices and load port.” |
| Data reliability: d) Where there are concerns related to data reliability and where practically feasible, the multi-stakeholder group should consider further efforts to address any gaps, inconsistencies and irregularities in the information disclosed . is encouraged to task the Independent Administrator with reconciling the volumes sold and revenues received by including the buying companies in the reporting process. | | |
| It is unclear what “further work” by multi-stakeholder groups entails. | Guidance for multi-stakeholder groups on how to assess and assure data reliability is provided in Guidance note 24 on data quality and assurance . This has typically related to reconciliation and data assurances to be provided by reporting entities. The final language related to reconciliation may be subject to discussion at the EITI Board and Implementation Committee level about reconciliation and data reliability. | “further efforts” |