



27.03.2013

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## Background Report: Commodities

### Report of the interdepartemental platform on commodities to the Federal Council

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#### Executive Summary

Switzerland has a long tradition as one of the world's leading centres of commodities trading, whose importance has risen markedly in recent decades. Because of growing public interest in the commodities industry and the importance of the issue for both domestic and foreign policy, the FDFA, the FDF, and the EAER informed the Federal Council in the spring of 2012 of their intention to prepare – in consultation with the concerned agencies of all of the Departments – a report addressed to the Federal Council summarizing the available information relevant to the issue of commodities trading in Switzerland, together with a discussion of the challenges connected therewith and a set of recommendations.<sup>1</sup> Many of the subjects dealt with in the report are relevant not only to the commodities industry. The report also recalls that Switzerland, as a rule, does not pursue economic policies tailored to individual sectors, but formulates policy to create overall favourable conditions for doing business in all sectors, including the commodities industry, and for the people involved therein both at home and abroad.

The present report underscores the sizable economic and fiscal importance of the commodities industry for Switzerland. For certain commodities – such as crude oil, for example – Switzerland is the world's most important centre of trade. It is estimated that around 500 companies and some 10,000 employees are active in the commodities industry, which, in addition to trading, also comprises shipping, transaction financing, inspections services and product testing. The commodity cluster contributes some 3.5% to Switzerland's GDP.

The reasons for Switzerland's major role in global commodity trading can be traced to the country's long tradition in the industry and to the favourable conditions found here for doing business in all sectors. These include a stable and predictable political, economic, and legal environment, a competitive corporate taxation regime and a business-friendly regulatory climate. In addition to other factors that contribute to Switzerland's appeal as business location, such as the availability of well-trained personnel and a generally high standard of living, the country's sophisticated and stable financial system make it particularly attractive as a commodity trading centre. Commodity traders must be able to rely upon the availability of a highly performative financial sector for the hedging of risks and the financing of transactions. Conversely, a robust commodity trading sector offers financial service providers a welcome opportunity for diversifying their business activities.

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<sup>1</sup> The security of Switzerland's supply with commodities is not subject of the present report. This issue has been dealt with in several reports answering Parliamentary requests.

The important place that Switzerland occupies in commodity trading brings with it a variety of challenges. As a business location, Switzerland faces intense international competition, also in the commodities industry, above all, from such places as Singapore, Dubai (United Arab Emirates), China (in particular, Hong Kong), the United States, the United Kingdom, and the Netherlands. Upcoming locations have succeeded in positioning themselves as attractive, as compared to Switzerland, particularly in the domains of taxation and regulatory costs, and actively campaign on their own behalf. There is no evidence, at present, of a general trend amongst companies to move away from Switzerland, but much will depend on whether Switzerland succeeds, also in the future, in providing a competitive legal and economic setting for conducting business. Switzerland thus faces the challenge of maintaining and strengthening the features that make it an attractive and reliable business location, including the competitiveness of its tax regime and the efficiency of its financial centres.

Switzerland has a strategic interest in supporting the sustainable development also of this industry. Commodities are strategic goods and the rising trade in commodities provides a stimulus for the job market and for tax revenues. As the industry increases in size, it brings with it additional challenges that must be taken seriously, among other, in the domain of human rights and environmental protection in resource-exporting countries, in the fight against corruption, and in connection with the phenomenon of the “resource curse” in developing countries. These challenges can also involve reputational risks for individual companies, and for Switzerland as a country, in particular, where the conduct of companies domiciled in Switzerland should run contrary to positions taken and supported by Switzerland in the domains of development policy, and the promotion of peace, human rights, and social and environmental standards.

All of these issues, and the questions tied to them – including those relating to transparency in product and finance flows, and in tax and regulatory matters – must be dealt with in a constructive and sufficiently nuanced manner, within the context of the country’s current financial, economic, foreign policy, and development policy objectives, and the solutions proposed should be presented before the appropriate international bodies. In this context, the merchandising of commodities and the extraction of resources must be treated as separate activities, even if certain international corporations operate in both sectors. The Federal Council expects of all companies operating in or out of Switzerland to conduct themselves responsibly, and with integrity, in complying with human rights, environmental, and social responsibility standards, both in Switzerland and abroad. It is especially in fragile states where governance is deficient that the population and the economy suffer as a result of non-compliance with international standards.

The present report, taking into consideration ongoing international developments, provides an overview of Switzerland’s commitments and the legal regime currently in force in Switzerland.

In the domain of financial regulation, the drafting of new statutory rules with respect to the off-exchange trade in derivatives is already underway. These reforms will increase transparency in derivative trading, including the trade in commodity derivatives, in keeping with the international standards by the G20 and the Financial Stability Board (FSB). In addition, Switzerland is today, for the most part, already in conformity with the International Organisation of Securities Commissions (IOSCO) Principles for the Regulation and Supervision of Commodity Derivatives Markets.

As concerns the fight against money-laundering, Switzerland implements the standards recommended by the Financial Action Task Force (FATF). Following the 2012 revision of the FATF recommendations, Switzerland now intends to strengthen its regime for combating money-laundering and the financing of terrorism. The consultation draft to this effect was passed by the Federal Council on 27.02.2013.

In formulating its policy on sanctions, Switzerland conforms with the resolutions of the UN Security Council. In addition, since 1998, Switzerland has also joined in sanctions enacted by the EU in practically all significant cases. Commodity sanctions are an important means of exerting pressure on countries and regimes, since they stop the flow of a significant source of revenues for the country against which the sanctions are directed.

With regard to financial flows between extractive industry companies and governments, the Federal Council welcomes greater transparency. For this reason, it actively participates in the Extractive Industries Transparency Initiative (EITI), and in this way promotes the disclosure of such payments. In addition, it follows attentively all international developments in this area, including regulatory projects in the USA (Dodd-Frank Act) and in the EU (financial reporting and transparency directives).

In international competition in respect of business location, an important consideration – even if it does not stand alone – is both the applicable rate of taxation and the structure of the tax regime. Certain of the corporate tax regimes currently in force in Switzerland have come in for criticism by the EU, because they treat domestic and foreign revenues differently. Within the framework of the Corporate Tax Reform III, currently being drafted, and the ongoing dialogue with the EU on corporate taxation, Switzerland's objective is to strengthen Switzerland's competitiveness as a business location, while seeking a solution that is adequate to the budgetary needs of the Confederation and the cantons and, at the same time, is also capable of finding a higher level of international acceptance.

Globally operative commodity groups – like other multinational enterprises – sometimes face criticism for setting up their corporate and transfer pricing structures in such a way as to shift their taxable income to countries with low rates of taxation. By means of double taxation agreements (DTAs) and tax information exchange agreements (TIEAs), Switzerland contributes to the ability of developing countries and emerging economies to take legal action against the use of abusive transfer pricing practices.

Because they often operate in fragile contexts, members of the commodity industry bear a special responsibility with regard, for example, to respect of human rights, the prevention of corruption, and protection of the environment. Although the primary responsibility for enforcing compliance with laws and standards lies, in principle, with the resource-extracting host states themselves, there is growing recognition internationally that with globalisation and the rising importance of private actors, additional solutions may be needed. Fragile and conflict-affected states often lack the capacities needed for dealing with these problems.

For this reason, Switzerland is actively involved in the development and implementation of international initiatives and standards, and supports various international instruments for the promotion of corporate social responsibility. It is expected of international corporations that, in addition to complying with statutory requirements both in Switzerland and abroad, they will also meet their duties of care and diligence as comprised in the notion of corporate social responsibility. Through its commitment to development, moreover, Switzerland contributes to the strengthening of governance in commodity-producing host countries. The central focuses of activity in this connection are, in particular, the building of democratic, legal, and tax policy capacities in the host countries, and the development of improved standards for transparency and financial reporting.

As concerns the existing legal situation with regard to the activities of multinational enterprises, it is to be noted that the right to bring action against a parent company before Swiss courts for acts committed by a subsidiary or a supplier in another country is limited, due, among other things, to the principle of territoriality. Swiss procedural law with regard to tort liability cases is based on the internationally recognised principle that jurisdiction should in all cases lie with the court that has the closest connection with the subject matter of the case and is thus in the best position to adjudicate on it.

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In conclusion, it may be stated that Switzerland already does a great deal to guarantee both its competitiveness and its integrity as a centre for conducting business, including the business of commodity merchanting. Nevertheless, there do remain areas in which Switzerland's efforts can and should be reinforced. Based on the findings presented in the report, the Federal Council approved the 17 recommendations made in chapter 6.

ted abroad only under restrictive conditions, such as that the offender be present on Swiss territory and the offence also be punishable in the country where it was committed.<sup>121</sup> Where natural persons are concerned, this applies, specifically, in cases where the offender or the victim is a Swiss national.

## **6. Conclusions and recommendations**

The commodities industry and, in particular, the merchandising of commodities, has developed into an important sector of the Swiss economy, making an increasingly significant contribution to value added, job creation, and tax revenues. Switzerland is one of the most important commodity trading centres in the world. Commodity trading conducted in a well-organised manner contributes globally to the efficient and sustainable allocation of natural resources.

Switzerland's central role in commodity trading naturally brings with it a number of complex challenges. Given the high degree of mobility characteristic of commodity companies, Switzerland faces increasing international competition in respect of business location, which has become particularly intense not only with certain EU Member States and the USA, but also with Singapore, Dubai and other Asian centres of business. This places Switzerland before the challenge of maintaining and strengthening the features that make it an attractive and reliable place for doing business, including the competitiveness of its tax regime and the efficiency of its financial centres.

At the same time, the commodities industry is also associated with other challenges that must be taken seriously, including the need to respect human rights and environmental standards in resource-exporting countries and the problem of governance deficiencies in many of those countries. These challenges may also bring with them reputational risks both for individual companies and for Switzerland. All of these issues, and the questions tied to them – including those relating to transparency in product and finance flows, and in tax and regulatory matters – must be dealt with in a constructive and sufficiently nuanced manner, within the context of the country's current financial, economic, foreign policy, and development policy objectives. In so doing, the commodity merchandising and resource extraction must be considered as separate activities, even if certain international corporations operate in both. The Federal Council expects of all companies operating in or out of Switzerland to conduct themselves responsibly, and with integrity, in complying with human rights, environmental, and social responsibility standards, both in Switzerland and abroad. It is especially in fragile states where governance is deficient that the population and the economy suffer the consequences of failure to comply with international standards.

As described in the present report, Switzerland does a great deal to guarantee both its competitiveness and its integrity as a centre for conducting business, including the business of commodity merchandising. With the exception of certain initiatives designed specifically for the commodities industry, this is done by creating for companies an overall climate that is conducive to doing business, in keeping with Switzerland's regular practice of not pursuing sectoral economic policies. In addition, Switzerland is today already active in various international bodies that deal with natural resource issues, such as the OECD, the World Bank, the IMF, and the Financial Stability Board, and engages in dialogue with the G20 in order to represent its own interests in an effective and coherent manner. There nevertheless remain areas in which Switzerland's efforts can and should be strengthened. These are addressed in the following recommendations.

### ***Attractiveness as a business location***

In connection with the commodities industry, while also taking into account other national objectives, high priority must be given to reinforcing Switzerland's competitiveness at the international level, to ensuring and enhancing market access, increasing resistance to crises, and maintaining the integrity of the financial centres.

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<sup>121</sup> See SCC art. 4-7, double punishability, offender not present on Swiss territory, or will not be extradited, etc.

**Recommendation 1:** *Switzerland should continue in its efforts to ensure that overall political, economic and legal conditions make it an attractive and reliable location for doing business in all sectors, including the commodities industry. The objective is to maintain Switzerland's prominent position as a competitive, transparent, and socially responsible merchanting centre and to sustainably secure the significant contributions in added value that the commodity companies make to Switzerland's overall economy. In the dialogue with the EU on corporate taxation, a solution should be found that preserves Switzerland's tax competitiveness as a business location, maintains budgetary balance in the cantons and the Confederation, and, at the same time, attains to a higher degree of international acceptance.*

**Recommendation 2:** *Switzerland should, as a matter of principle, implement existing multilateral standards for the commodities industry. When introducing its own regulatory provisions, care should be taken to make certain that the measures have been agreed upon multilaterally so that they do not negatively influence overall conditions for companies based in Switzerland, as compared with those in competing business locations. At the international level, Switzerland should work actively both in the drafting and in the implementation of regulatory standards to make certain that they create the conditions for a level playing field worldwide.*

### **Transparency**

In the domain of financial market regulation, the relevant international standards have already been implemented and the requisite reforms have been undertaken. Thus, for example, the reform of the markets for off-exchange traded derivatives – including the commodity derivative markets – will increase the transparency of derivative trading. Switzerland has today already satisfied the majority of the IOSCO Principles for the Regulation and Supervision of Commodity Derivatives Markets. It is neither purposeful nor appropriate for proprietary trading in derivatives by physical commodity dealers to be made subject to the licensing requirement applicable to financial intermediaries.

**Recommendation 3:** *With regard to the IOSCO Principles for the Regulation and Supervision of Commodity Derivatives Markets, the FDF, working together with the FINMA, should conduct an analysis as to whether any action is required. Their findings should be taken into account, insofar as possible, as part of the revision of the regime governing off-exchange traded derivatives (OTC derivatives) currently being undertaken. In implementing the reforms of the OTC derivative markets, care should be taken to ensure, insofar as possible, that hedging transactions by commodity traders are not rendered more difficult and that Swiss commodity companies are not prejudiced in their economic interests to any greater extent than their counterparts in the EU or the USA.*

The Federal Council rejects toleration of any inflows into Switzerland of monies obtained in an illicit manner, and has developed a wide range of instruments to prevent such inflows. These include measures for combating (a) money laundering, (b) tax violations, and (c) corruption; (d) and for the repatriation of assets stolen by politically exposed persons. In the fight against money laundering, Switzerland implements international standards, and, in doing so, goes in part further than other countries. Commodity traders, insofar as they also act as financial intermediaries (client traders), are today already subject to the Anti-Money Laundering Act.

**Recommendation 4:** *The regime for combating illegal financial flows should be reviewed on a regular basis and, where called for in the face of new risks that may also arise as a result of unlawful gains from commodity dealing, be adapted accordingly. As part of the revision now underway for implementation of the revised FATF recommendations, measures are proposed to further strengthen the regime in place for combating money laundering so that money-laundering abuses within the commodities industry can also be prevented.*

Switzerland considers itself as bound by the principles of fair taxation practices between States. It rejects tax evasion and tax avoidance and participates in the international discussion on tax policies in connection with the issue of base erosion and profit shifting (BEPS).

**Recommendation 5:** *Switzerland should actively support the discussion in the OECD on possible ways of curbing tax avoidance and review implementation of the results in Switzerland. In that context, it is also important that fundamental legal principles be respected and that a level playing field in competition in the domains of taxation and subsidies be assured.*

With regard to the issue of transparency in physical commodity trading, the G20 has launched various initiatives, such as the Joint Organisations Data Initiative Oil (JODI Oil), the Agricultural Market Information System (AMIS), and the initiative to improve the functioning of the Oil Price Reporting Agencies.

**Recommendation 6:** *The G20 initiatives to increase transparency with regard to prices and quantities in the physical commodities markets should be supported in multilateral forums.*

Improvements in transparency with regard to financial flows from resource extraction companies to governments are to be welcomed. For this reason, Switzerland is an active participant in the Extractive Industries Transparency Initiative (EITI). The advantages of the EITI are, firstly, that the standard is developed jointly by NGOs, companies, and governments, which fosters both its applicability and its sustainability; and, secondly, that more transparency is demanded not only of companies but also of governments. This approach helps, moreover, to ensure a level playing field for all companies operating in competition with each other in the same resource-producing country.

**Recommendation 7:** *Switzerland should strengthen its commitment to the Extractive Industries Transparency Initiative (EITI), and actively work to enhance the influence of the EITI. In particular, Switzerland should express its support, in principle, for the proposals for reforming the EITI that are currently being discussed. These relate, among other things, to reporting requirements on financial flows on a project-specific basis and on sales by national oil companies to commodity trading companies (including those domiciled in Switzerland). At the same time, the proposals aim, while taking into account the potential sensitivity of certain business information, to promote the transparency of government contacts through the disclosure of extraction agreements between governments and commodity companies.*

**Recommendation 8:** *The consequences of a potential introduction of transparency requirements – similar to those of the USA and the EU – for the Swiss commodity sector should be examined – and the drafting of a consultation draft should be considered. Switzerland should, moreover, advocate internationally a global standard that foresees transparency requirements that are clearly understandable and as similar as possible for all companies active in the extraction of resources.*

International efforts are also underway to increase transparency with regard to product flows. The aim here is to prevent products that have been extracted in breach of human rights or environmental standards, or that are used for the financing of conflicts, from passing into the market supply chain. Thus, for example, Switzerland was in 2003 among the founders of the Kimberley Process, whose objective is to eliminate conflict diamonds from the international diamond trade.

With regard to the gold trade, where, contrary to the situation in the merchandising of other commodities, the gold physically enters Swiss territory, the Federal Council is prepared to consider breaking down the foreign trade statistics on a country-by-country basis in the future. A working group under the direction of the FDF, or, more specifically, of the Federal Customs Administration, will prepare proposals in this regard.

**Recommendation 9:** *Switzerland should continue to actively promote international initiatives for increasing the transparency of product flows – such as the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas – and should implement the standards adopted. In addition, Switzerland should launch this year, as planned, the “Better Gold Initiative” for the creation of a value chain for the fair and sustainable extraction and trading of gold. Switzerland’s foreign gold trade statistics should be broken down on a country-by-country basis in order to increase transparency in this domain. Concrete proposals for the publication of statistics should be worked out by the working group appointed by the FDF.*

### **Corporate responsibility and government responsibility**

Corporate social responsibility is an issue that concerns not only companies in the commodities industry, but all companies and, in particular, multinational corporations. Companies involved in resource extraction nevertheless face special challenges, in that they often operate in unstable regions where the rule of law is weak. In order to promote compliance with human rights and environmental standards, Switzerland supports, among other things, the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, and the “Voluntary Principles on Security and Human Rights” and is active in efforts to ensure that they are implemented by Switzerland, by companies, and by the other States. In implementation of the 2011 update of the OECD Guidelines, the Federal Council is currently in the process of reorganising the National Contact Point (NCP) so as to strengthen its effectiveness among the various stakeholders and within the Federal Administration, and to improve the efficiency of its mediation efforts. In addition, the FDFA and the EAER in 2012 launched a multi-stakeholder dialogue with NGOs, companies, and academic institutions on the implementation of the UN Guiding Principles on Business and Human Rights. At the end of 2012, the National Council then also instructed the Federal Council to prepare a report on a strategy to implement the UN Guiding Principles on Business and Human Rights.

**Recommendation 10:** *Switzerland should continue in its commitment to promote corporate social responsibility and intensify the multi-stakeholder dialogue being conducted by the FDFA and the EAER on the UN Guiding Principles on Business and Human Rights. In conformity with Postulate 12.3503, “A Ruggie Strategy for Switzerland”, as submitted by von Graffenried, a review of the existing regime should be conducted, the gaps identified, and measures needed for implementation of the UN Guiding Principles defined. Swiss companies should, in keeping with the principles of corporate social responsibility, exercise due diligence with regard to human rights and the environment – particularly when operating in fragile states – and institute measures to minimise risks, contributing thus to the positive image of the companies themselves and of Switzerland as a business location. Switzerland should focus its efforts to implement its state duties and promote corporate responsibilities within both resource extraction and merchanting.*

**Recommendation 11:** *A working group, in cooperation with representatives of the stakeholders involved (specifically, the cantons, as well as companies and NGOs) should prepare proposals for corporate social responsibility standards (including implementation mechanisms) for the commodity merchanting industry. Based on those proposals, consideration should be given to the submission of initiatives and international guidelines – designed, specifically, also to deal with ecological effects – before the appropriate international bodies.*

In keeping with the request of the Foreign Affairs Committee of the National Council (Postulate 12.3980), a comparison of the applicable laws should be undertaken in a report to determine whether and, if yes, in what way, corporate board members in countries comparable to Switzerland are obligated by law to exercise due diligence with regard to human rights and environmental standards in their companies’ overseas operations. Based on the results of that comparative study, solutions suitable for Switzerland should be formulated. This should be done in coordination with other countries and international organisations.

**Recommendation 12:** *Based on the results of the comparative study of other legal regimes (Foreign Affairs Committee of the National Council, Postulate 12.3980), a review should be conducted to determine whether the international legal environment is such that there is a need for Switzerland to take legislative action.*

### **Development policy**

In addition to the above-mentioned initiatives (EITI, Better Gold), Switzerland, as part of its development cooperation activities, also provides assistance to developing countries and emerging economies in their efforts to improve overall conditions and build governance capacities. This is crucial in order for resource-rich developing countries to be able to better exploit their potential; the efforts undertaken aim, among other things, to strengthen rule of law structures and democratic monitoring mechanisms, to mobilise internal resources, and to promote efficient and effective systems for the administration of public finances.

**Recommendation 13:** *Switzerland should continue in its existing bilateral and global commitment to development cooperation and cooperation with Eastern Europe for the promotion of good governance and should intensify its efforts in specific areas, such as those of democratic monitoring mechanisms, government capacity building, and efficient management of resource extraction revenues. This will fundamentally strengthen the abilities of resource-producing countries to reduce such risks as money-laundering, corruption, the flight of capital, and tax avoidance.*

### **Double taxation agreements and transfer pricing**

By means of double taxation agreements (DTAs) and tax information exchange agreements (TIEA) with developing countries and emerging economies, Switzerland contributes to the ability of those countries to take legal action to counter the use of abusive transfer pricing practices. These agreements can assist developing countries in mobilising their internal resources.

**Recommendation 14:** *In keeping with the current policy of the Federal Council, the conclusion of TIEAs with developing countries should be taken into consideration, whereby, however, in the presence of economic interests, and for the prevention of double taxation, the conclusion of DTAs is to be given preference. DTAs and TIEAs are fully effective only where the partner country possesses the requisite government capacities.*

### **Reputational risks**

The sizeable economic importance of the commodities industry has also given rise to heightened public interest. One aspect of the public debate are questions concerning the economic and political risks to which Switzerland may be exposed through the presence of a large number of commodity companies on its territory. The measures recommended in this report constitute an important contribution to reducing reputational risks. At the same time, however, Switzerland should work to further enhance its ability to monitor developments in the commodities sector.

**Recommendation 15:** *Developments both in the political debate and in the public debate in the media, in Switzerland and abroad, should continue to be monitored so that potential risks to Switzerland's reputation or to its attractiveness as a business location can be recognised early. Specifically, Swiss representations abroad should devote greater attention to the issue in their reports and contribute to the gathering of more detailed information. In addition, measures should be taken to strengthen efforts to inform the public on Switzerland's commitment to preserving the integrity and the competitiveness of the commodities industry here.*



### ***Dialogue with actors outside the Confederation and interdepartmental platform***

Various federal departments engage in dialogue with the cantons on the one hand and the industry (companies and industry associations) as well as with NGOs on the other, on different aspects of the commodities issue. Within the federal administration, an interdepartmental platform has been created in order to develop the foundations for dealing with natural resource issues. Measures currently being implemented are, for the most part, embedded in projects now being carried out by various federal departments and do not exclusively concern the commodities industry.

***Recommendation 16:*** *Contacts between the Departments, in their respective domains of responsibility, with the cantons as well as the industry (companies and industry associations) and NGOs, should continue, and be intensified, with the objective of identifying opportunities and risks and discussing common approaches to addressing these issues.*

***Recommendation 17:*** *The interdepartmental platform on commodities should remain in function in order to assure the proper flow of and concentration of information within the Federal Administration, to monitor and provide early recognition of international and national developments, and to coordinate dialogue with the cantons, the industry, and NGOs. It ensures reporting.*