



Eidgenössische Bankenkommission  
Commission fédérale des banques  
Commissione federale delle banche  
Swiss Federal Banking Commission

**Report on the activity of Swiss-based  
banks in the United Nations  
Oil-for-Food Programme  
(SFBC Report on Oil-for-Food)**

**October 27, 2005**



## 1 United Nations Oil-for-Food Programme in Iraq

On April 21, 2004, the United Nations (UN) Security Council unanimously adopted resolution 1538 and thereby confirmed the creation and mandate of the **Independent Inquiry Committee into the United Nations Oil-for-Food Programme (IIC)**, with a remit to investigate efforts by the former Iraqi Government to circumvent the provisions of resolution 661 of August 6, 1990 and subsequent relevant resolutions. The IIC's mandate was to collect and examine allegations of bribery, kickbacks, surcharges on oil sales, and illicit payments in regard to purchases of humanitarian goods in connection with the Oil-for-Food Programme. Resolution 1538 calls upon all UN Member States to cooperate fully with the IIC.

The **Oil-for-Food Programme** (Programme) was set up following long and difficult negotiations with the Iraqi Government. UN Security Council resolution 661 imposed economic sanctions on Iraq following the invasion of Kuwait. In 1991, after the first Gulf War, resolution 706 was adopted to mitigate the impact of embargo measures on the Iraqi people by making it possible to finance the purchase of humanitarian goods through the sale of oil under the supervision of the UN. There was no follow up on the resolution for four years as no agreement was reached with the Iraqi Government, which would not accept some of the conditions imposed by the Security Council. On April 14, 1995, the adoption of resolution 986 reopened negotiations, which after 18 months gave rise to a Memorandum of Understanding establishing the terms and conditions of the Programme.

The **conditions negotiated by the Iraqi Government** made it possible for Iraq to keep control over the selection of parties purchasing oil and selling humanitarian goods. Under the procedure applicable to oil transactions, the purchasers proposed by Iraq were to be approved by a special UN committee. Basically, subject to UN approval, the selection of the purchasers was left to the Iraqi Government. Oil prices were set by the UN and had to be paid in full into an escrow account at the New York headquarters of the French bank Banque Nationale de Paris (now BNP Paribas). Pursuant to the terms and conditions of the Programme all the letters of credit issued by the banks to finance oil purchases had to be made in favor of the UN on its account at Banque Nationale de Paris in New York. The purpose of the escrow account was to ensure that all the revenues generated by the Programme were managed by the UN for the benefit of the Iraqi people. There were no special restrictions applicable to the resale of oil by the approved purchasers.

To set out the results of its inquiries, the IIC has published four reports on various aspects of the Programme since the beginning of this year<sup>1</sup>. Today, the IIC is publishing its latest report on possible violations of the rules for the Programme by persons or entities (outside the UN) participating directly or indirectly, including in particular traders of oil and humanitarian goods and, to a certain extent, financial institutions.

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<sup>1</sup> <http://www.iic-offp.org/documents.htm>



## 2 The intervention of the Swiss Federal Banking Commission

Through its intervention, the Swiss Federal Banking Commission (SFBC) primarily sought to **clarify compliance with the applicable due diligence obligations by Swiss-based banks** in the context of the Programme. Certain banks based in Geneva are known for their expertise in financing oil trading transactions. The SFBC prioritised this case and assembled a working group as early as June 2004. The SFBC's collaboration with the IIC proved very useful as the IIC had privileged information that facilitated the identification of sensitive bank client relations and transactions.

The second motive concerns the **administrative assistance** that the SFBC provided to State Secretariat for Economic Affairs (seco) under Art. 6 of the Embargo Act (RS 946.231). The numerous requests made by the IIC between October 2004 and October 2005 to the Swiss authorities were processed by the seco in accordance with Art. 7 of the Embargo Act. In this context, the IIC offered guarantees that all the information received from seco would be treated confidentially. A large portion of the information and documents requested from Switzerland related to bank relations. Following various interdepartmental meetings amongst Federal authorities (seco, Federal Department of Foreign Affairs, Federal Department of Justice and Police, Office of the Attorney General of Switzerland), the SFBC agreed to request the relevant information and documents on behalf of seco as well. On December 22, 2004, the Federal Council approved this procedure for the transmission of information and documents to the IIC. In its September 7, 2005 report, the IIC has explicitly mentioned the excellent cooperation provided by the seco and the SFBC.

## 3 Activity of Swiss-based banks

Based on the information obtained for the IIC, the SFBC has been able to determine in what capacity Swiss-based banks were involved in the financial transactions of companies or persons that were involved or participated in the Programme.

- On behalf of some of their **oil trading clients**, the banks (i) financed the purchase of Iraqi oil based on letters of credit issued in favor of the UN under the Programme; and (ii) executed transactions ordered by oil traders to third parties.
- To a lesser extent, on behalf of certain **private clients** involved in the Programme (e.g. the beneficial owners of oil trading companies or of their contracting partners), for which they maintained bank accounts and executed payments.

According to the information received from the IIC by the SFBC, about half of the USD 64 billion-worth of oil contracts were financed in Switzerland. The importance of the activities of Swiss-based banks in the Programme comes as no surprise. The liberalisation of oil prices following the 1973-74 oil crisis came as an opportunity for a large number of oil traders, a number of whom decided to set up in Geneva, a renowned international



trading centre. According to various sources, some 25% of oil available for sale (not attributed to major oil companies) is financed through the Geneva financial centre. Out of the 90 million barrels of oil produced daily, between 35 and 40% is available on the open market, i.e. roughly 35 million barrels. Thus, every day approximately 8.75 million barrels of oil are financed by Geneva-based banks. Based on the information gathered, the SFBC considers that the transactions carried out within the scope of the Programme were of limited importance, accounting for roughly 5% of the total volumes of transactions financed by Geneva-based banks.

#### **4 Due diligence obligations of Swiss-based banks**

The SFBC's practise and the Swiss legislation have long required banks to exercise a high degree of due diligence with respect to their business relations. Banks are not only required to verify the identity of account holders, but also of beneficial owners. In the event that transactions or business relations seem unusual, the financial intermediary must clarify their purpose and financial background, except where they are manifestly legal. Banks are also obliged to obtain and maintain documents and take the required internal organisational measures. These practices and legal obligations were applicable to banks in the context of trade finance, also during the Programme. The banks' practices relating to these due diligence obligations have been strengthened over recent years. Moreover, the SFBC has adopted the Ordinance concerning the Prevention of Money Laundering, which has been applicable to all Swiss banks since July 1, 2003 and provides explicitly that banks have to systematically identify higher risks client relations and transactions. Clarifications must be sought and documented on the background of such relations and transactions. However, there are no standards specifically applicable to trade finance in Switzerland. The SFBC has no knowledge of any such specific standards at the international level.

#### **5 Assessment of compliance with due diligence obligations**

The SFBC has examined compliance with the due diligence obligations applicable to Swiss-based banks that have (i) issued letters of credit in favor of the UN in the context of the purchase of Iraqi oil, and (ii) executed related transactions ordered by clients connected to the Programme.

On the basis of these clarifications and the information available to it, the SFBC has arrived at the following provisional conclusions:

- Swiss-based banks have been involved in **oil trading operations** through the financing of Iraqi oil purchases with letters of credit issued in favor of the UN. In accordance with the terms of the Programme and their due diligence obligations, the banks have systematically ensured (i) that purchasers designated by the Iraqi Gov-



ernment were duly approved by the UN, (ii) that the UN was the beneficiary of the letters of credit for the total price of the oil, and (iii) that the form and conditions of the letters of credit were in line with UN stipulations. These were the only specific requirements of which trade finance banks active in the Programme were aware. The UN did not impose any particular restrictions on the resale of the oil by approved purchasers.

In a relatively large number of oil finance transactions, the purchaser selected by the Iraqi Government lacked the financial resources to pay for and/or did not have the necessary expertise to commercialise the oil allocated to them. Purchasers therefore turned to true oil traders who purchased the Iraqi oil for their own account but in the name of the approved purchasers. For the purposes of these transactions, the banks issued letters of credit in the name of the approved purchaser in favor of the UN, but under the financial responsibility of their clients, the oil traders. These clients were duly identified and known by the banks. In the practise of oil trade finance, these approved purchasers are regarded as contract holders. This “**contract holder**” practise was brought to the attention of the UN Sanctions Committee by the UN Oil Overseers during the Programme. It is not peculiar to the Programme, and is fairly widespread in free oil trading, where it has a legitimate commercial purpose. For instance, amongst groups of trading companies, some entities will be responsible for identifying purchase opportunities while others will deal with financing the resulting transactions. In addition, information currently available to the SFBC indicates that the practice has not prevented the UN from receiving the full price it set.

On the basis of the information currently available to the SFBC and the information that the banks could access at the time, the oil transactions financed by the Swiss-based banks are usual and in line with the applicable business practices and generally did not require a higher level of due diligence.

- From the start of its inquiry, the IIC has had access to numerous sources of privileged information (including various national agencies and members of the former Iraqi Government). This information has enabled it to target its requests and to reconstruct payment chains that it knows to correspond to **payments of commissions without legitimate economic rationale**. A number of transactions ordered by oil traders, UN-approved companies or entities or persons linked to such companies appear to fall into this category. During the course of the Programme there were rumors on the markets to the effect that the Iraqi Government was asking for commissions. These rumors were known to the oil traders as well as the bank employees involved in oil trade finance. The implementation of concrete measures by the banks was rendered difficult by the absence of information on the persons or entities close to the Iraqi Government who were parties to these transactions. On the basis of the information and banking documentation currently available, the SFBC has not identified transactions, which should have appeared suspicious or illegal in view of the information available to the banks at the time.



## **6 Conclusion and additional measures**

The clarifications sought by the SFBC have so far not brought to light any violations of the due diligence obligations applicable to the banks. This assessment is based on the voluminous banking documentation reviewed by the SFBC. It considers the information that were available to the banks at the time of the transactions. The SFBC will carefully review the content of the report published today by the IIC. Should new facts be brought to its attention, the SFBC will reinstate its inquiry into the activities of the Swiss-based banks in the context of the Oil-for-Food Programme, launch the required proceedings and take the necessary prudential measures.