Title: Implementation of Chapter 6 EU Transparency Directive - Country by Country Reporting	Impact Assessment (IA)
IA No:	**Date:** 16/10/2014
Lead department or agency: HM Treasury	**Stage:** Development/Options
	Source of intervention: EU
Other departments or agencies: No	**Type of measure:** Secondary legislation
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Summary: Intervention and Options

RPC Opinion: RPC Opinion Status

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
-347.27m	-347.27m	33.61m	YES (one year)	IN

What is the problem under consideration? Why is government intervention necessary?

Across the world, natural resources make substantial contributions to the public budgets of many developing countries. However, the citizens of these countries often remain extremely poor. This is in part because many governments of developing countries have failed to responsibly manage the large payments made to them by extractives companies in return for access to natural resources. The absence of good governance and the lack of transparency around these payments reduce the positive impact that extractive industries can have on economic development. It also negatively impacts on UK listed companies and investors active in the extractives sector through poor business environment.

What are the policy objectives and the intended effects?

Chapter 6 of TD now requires EU listed extractive companies to report their payments to governments around the world. This is intended to improve accountability by allowing citizens in these countries to access information about payments made, and increase their ability to hold their governments to account regarding use of the revenues. This relies on the assumption that the democratic processes in the relevant countries are robust enough to allow citizens to hold governments to account in the presence of information about payments. By improving accountability, the policy aims to reduce the space for corruption and other illicit activities, and ensure that citizens of developing countries benefit appropriately.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

0. Do nothing - used solely as a counterfactual, it is not feasible as it is an agreed EU Directive, and alternatives to regulation are not available. We only have flexibility on how to implement the provisions.
1. Implement Chapter 6 by the transposition deadline (26 Nov 2015).
2. Implement Chapter 6 early, with reporting requirements to apply to reporting periods commencing on or after 1 January 2015.

Our preferred option is Option 2. Early implementation will ensure benefits to UK extractive companies and investors accrue as soon as possible. A commitment has been given by the Prime Minister to implement the reporting requirements quickly in recognition that these new requirements represent a significant step forward in fighting corruption in developing countries and in helping to ensure those countries' citizens benefit from the funds transferred.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 11/2017

Does implementation go beyond minimum EU requirements?			Yes		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** No	**< 20** No	**Small** No	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** 0	**Non-traded:** 0	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: Andrea Leadsom Date: 12/12/14

Summary: Analysis & Evidence

Policy Option 1

Description: Implement Chapter 6 by the transposition deadline (26 Nov 2015)

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
2011	2014	10	**Low:** N/A	**High:** N/A	**Best Estimate:** -347.27

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A		N/A	N/A
High	N/A		N/A	N/A
Best Estimate	106.2		29.9m	347.3m

Description and scale of key monetised costs by 'main affected groups'

The main affected groups are UK listed extractive companies, that are not registered in the UK (the Accounting Directive will account for UK registered extractive companies). There are significant transition and annualised costs to firms in this area. The transition costs to firms are 106.2m and 36.27m

Other key non-monetised costs by 'main affected groups'

It is possible that this measure will place UK listed companies at a competitive disadvantage compared to non-EU listed, non-EU registered, non-US registered firms. Whilst disclosing payments to governments will not give direct insight into the levels of turnover, costs and profits that an extractives company generates, confidential business data could be revealed from such data. Other indirect costs to companies operating in countries where disclosure of such information is prohibited by criminal law.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A		N/A	N/A
High	N/A		N/A	N/A
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

We have not been able to monetise the benefits of this policy to individual firms.

Other key non-monetised benefits by 'main affected groups'

The non-monetised benefits to UK listed companies from this measure include unquantified benefits to business and investors. These benefits are associated with an improved political and economic operating environment arising from promoting accountability and good governance. This will improve the operating environment and reduce operating risk for extractives companies, and improve transparency with in relation to company activity and project risk for investors.

Key assumptions/sensitivities/risks **Discount rate** 3.5%

The responses from the AD consultation did not provide quantitative cost estimates. As a result, we have been forced to use a proportionate analysis that is more qualitative in nature.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 33.6	**Benefits:** 0	**Net: -33.6**	NO	N/A

Summary: Analysis & Evidence — Policy Option 2

Description: Implement Chapter 6 early

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2014	Time Period Years 1	Net Benefit (Present Value (PV)) (£m)		
			Low: N/A	**High:** N/A	**Best Estimate:** N/A

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	N/A		N/A	N/A
High	N/A		N/A	N/A
Best Estimate	106.2		29.9m	347.3m

Description and scale of key monetised costs by 'main affected groups'

As with option 1, the main affected groups are UK listed extractive companies that are not registered in the UK (the Accounting Directive covers UK registered extractive companies). Introducing the elements of the Transparency Directive relating to extractive industries on 1 January 2015 (11 months early) imposes an additional year of reporting on virtually all (this IA assumes all) such companies. As such, its relative cost as compared to the counterfactual case (policy option 1) is one year's annual running costs to firms.

Other key non-monetised costs by 'main affected groups'

As with option 1, but realised a year earlier. As a result, there is greater potential for UK listed firms to be (temporarily) disadvantaged as compared to firms listed in other EU countries. However, under this policy option, all UK listed firms are treated equally regardless of their registration status, thus removing a second potential source of market distortion. Unfortunately, we have been unable to monetise these effects due to their intangible nature (see below).

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	N/A		N/A	N/A
High	N/A		N/A	N/A
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

As with option 1, we have not been able to monetise the benefits of this policy to individual firms.

Other key non-monetised benefits by 'main affected groups'

As with option 1, but realised a year earlier.

Key assumptions/sensitivities/risks	**Discount rate**	3.5%

As with option 1.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 33.6m	**Benefits:** 0	**Net:** 33.6m	Yes	IN

Evidence Base (for summary sheets)

EXECUTIVE SUMMARY

(i) Problem under consideration and rationale for intervention

- Across the world, natural resources, such as oil, gas and minerals, are worth billions of dollars to developing countries.
- However, whilst many of the world's poorest countries have huge reserves of valuable natural resources, their citizens often remain extremely poor. This can be because many governments of developing countries have failed to manage successfully the large payments made to them by extractives companies in return for access to natural resources.
- The absence of good governance therefore significantly reduces the positive impact that extractives industries can have on local economies and local people.
- There is an **economic efficiency** rationale for intervention to help developing countries address the government failures in their own administrations. Even though this economic inefficiency originates outside UK jurisdiction, the benefits of addressing this failure are likely to have economic benefits to UK and are therefore in scope in terms of the Green Book.
- For instance, if the Directive effectively inspires greater transparency, less **information asymmetry** and less corruption through enabling citizens to hold their governments to account, and this results in more efficient use of resources by governments and less unrest among citizens. This will enable UK extractive companies to benefit from an improved operating environment. With greater political and economic stability in the countries they operate in, UK extractive companies will incur less disruption and be able to carry out extractive activity more consistently and at a lower cost than under the status quo. For example, as of July 2007, Royal Dutch Shell reported that 195,000 barrels of oil a day remained trapped in Nigeria, with a daily price tag for the company of nearly $16 million. Lack of economic opportunity, both real and perceived, is identified as one of the key factors contributing to violence and the disruption of

operations in the region. Greater stability and transparency will also enable UK investors to make improved investment decisions as there will be less information asymmetry between investors and local managers.

(ii) Options and policy objectives

- The aim of Chapter 6 is to raise global standards of transparency in the extractives sector by requiring companies to report publicly the payments they make to governments in all their countries of operation.
- **Option 0**: Do nothing. This is an artificial construction representing a world in which the EU had not legislated in this area. In practice, the only discretion member states have is during implementation, as outlined in option 1 and 2. It is used solely for the construction of an EANCB for Option 1.
- **Option 1**: proposes implementing the Directive on 26 November 2015, the transposition date set by the Commission. Implementation on this date would require extractives companies to begin reporting any payments they have made to governments for financial years beginning on or after 26 November 2015. Although not the focus of this impact assessment, an EANCB and associated costings have been prepared, with Option 0 as the counterfactual.
- **Option 2**: This option proposes implementing the Directive early, by bringing regulations into force in December 2014 to apply to financial years beginning on or after 1 January 2015. As gold-plating, it is costed against Option 1.
- **Option 2 is our preferred option.**

(iii) Costs and Benefits

- Option 1 and Option 2 are the same apart from the timing of implementation, therefore the nature of the costs and benefits are the same for both options.
- The costs in both cases fall on the 80 UK listed companies which carry out extractive activity.

- The UK specific **benefits** associated with introducing this measure include unquantified benefits to business and investors associated with an improved operating environment.
- There is a monetised **cost** to UK listed companies arising from increased reporting costs, however, these reporting costs only run for 11 months before the Transparency Directive transposition deadline. It has been difficult to calculate these monetised costs as we received very little evidence during the Accounting Directive country by country reporting consultation, which was launched in May 2014.
- There is also a potential non-monetised cost associated with the possibility that aspects of this measure put UK firms at a competitive disadvantage with respect to non-EU firms.
- The number of entities in scope and information has been obtained using the London Stock Exchange listing database.
- The consultation sought further information on the costs and benefits of implementing the directive early. Industry described a range of costs associated with setting up systems and on-going costs, rather than specifically quantifying any additional costs for early implementation.
- Given that it is not possible to monetise the majority of the costs and benefits, it is not possible to recommend either of the options on economic efficiency grounds alone. However, it is clear that there is a strong international equity argument for implementing the directive early.
- There are no concerns associated with the wider impact tests.

BACKGROUND

1. The Transparency Directive (TD) harmonises the transparency requirements regarding information about issuers whose securities are admitted to trading on a regulated market in the EU. The amended TD aims to improve the existing regime by simplifying and improving the application for small and medium-sized issuers in particular, reducing legal uncertainties and further enhancing investor protection, where necessary.

2. The new TD was published in the Official Journal of the EU (OJEU) on 6 November 2013. It applies 20 days after publication in the OJEU and Member States have 24 months from the date of application to transpose the directive into national law. This will mean that by 26 November 2015 industry will have to comply. The necessary UK legislation will be brought into effect just before that date.

3. Chapter 6 of TD now requires EU listed extractive companies to report their payments to governments around the world. This policy is in line with Chapter 10 of the Accounting Directive (AD), which applies to all large UK registered companies. In this case 'large' is defined as having a net turnover of £40million or more and an average number of employees of 250 or more.

4. As part of the UK's G8 Presidency it was agreed that EU G8 countries (UK, France, Germany and Italy) *"will quickly implement the EU Accounting and Transparency Directives"* to raise global standards for extractives transparency. The extractives reporting element of the AD is being transposed by 1 January 2015, earlier than the transposition deadline of 20 July 2015.

5. The aim of the impact assessment is to highlight the costs and benefits associated with the early implementation of the country by country reporting requirement to be in force by 1 January 2015, in line with the Accounting Directive.

PROBLEM UNDER CONSIDERATION

6. Across the world, natural resources, such as oil, gas and minerals, are worth billions of dollars to developing countries. Africa's natural resources were worth $246 billion in

exports in 2009 – a figure which is 6 times greater than Official Development Assistance (ODA).

7. While there are variations from country to country, the proceeds from oil, gas and mineral extraction make substantial contributions to the public budgets of many developing countries. The IMF Revenue Transparency Report states that oil, gas and mineral resources account for over 50% of government revenue or export proceeds in many low and middle income resource rich countries4, whilst in 2005 the Shell Group paid $18 billion in government taxes in its countries of operation throughout the world.

8. However, whilst many of the world's poorest countries have huge reserves of valuable natural resources, their citizens often remain extremely poor. This can be because governments of developing countries have failed to manage successfully the large payments made to them by extractives companies in return for access to natural resources.

9. The absence of good governance therefore significantly reduces the positive impact that extractives industries can have on local economies and local people.

10. Transparency around the payments extractives companies make to governments will provide these citizens of resource-rich developing countries with the information they need to help hold their governments to account and help ensure that the income is invested in local people and services.

11. Publish What You Pay (PWYP), a global network of civil society organisations that campaigns for an open and accountable extractives sector, argues that "Citizens and civil society need to be able to access information about extractives revenues to hold governments and companies accountable, ensuring that natural resources generate benefits for the whole population. Resource transparency reduces corruption and the costs of capital for developing countries and encourages foreign direct investment through a more stable business climate".

12. In addition, Shell states that "We believe that transparency promotes good government, helping to ensure that the billions of dollars the energy industry pays in tax benefits society as a whole, rather than a privileged minority."

13. Badly functioning local economies can also create difficult and potentially damaging operating environments for UK extractives companies which is likely to impact on profits.

14. The UK is an important actor in the global extractives industry, and there are 80 UK listed extractive companies in scope of the TD.

15. Due to the nature of the work they are engaged in, the extractives industries have a much longer time horizon than many other industries. They are relatively immobile, given that they must locate themselves wherever minerals and energy deposits exist. They are therefore more easily affected by unstable economic and political environments than other sectors and have a particular interest in expanding economic opportunity and increasing political stability in their countries of operation.

16. However, in the absence of an extractives reporting requirement, there is no reliable information available on the current level of payments made by extractives operators to host governments. This affects both the local community's ability to hold its government to account for its use of the funds, which directly influences the political and economic stability of the country. It also improves extractives companies' knowledge regarding the level of corruption in the country, which in turn will influence their degree of assurance as to the political and economic stability of the country This stability – in both senses – is likely to affect both forecast and actual costs and hence improve profits both directly and through better decision-making.

17. Importantly, transparency also affects companies' ability to demonstrate the size of the contribution they make to host countries and thereby boost their reputation and their "social licence" to operate. Tullow Oil believes that "Transparency creates the opportunity to more effectively manage expectations of what socio-economic impact the discovery of oil can have over what time frame. Further, it provides greater insight

into how our industry operates and demonstrates the range of economic contributions that we can bring to a country."

18. A lack of transparency around payments made to governments reduces the ability of investors to assess the level of corruption in the country related to extractive projects, which negatively impacts investors' ability to assess the risk profiles of extractives projects and make effective investment decisions. This is especially the case in countries where governance is weak, as the resulting corruption, bribery and conflict can negatively affect the sustainability of a company's operations and therefore the profitability of investments.

19. Currently available data suggests that payments are likely to run into many billions. In a survey of 11 country reports, the Extractive Industries Transparency Initiative (EITI) reported that the surveyed host governments annually received collectively US$43.5billion from the oil, gas, mining and timber industries. To put this figure in context, the payments represent, on average, 11.5% of these countries' GDP. The European Commission Services estimated that listed EU oil and gas companies could collectively have made payments (including taxes, bonuses and royalties) to governments worldwide of €362 billion in 2009.

RATIONALE FOR INTERVENTION

20. There is an **economic efficiency** rationale for intervention to help developing countries address the government failures in their own administrations. Even though this economic inefficiency originates outside UK jurisdiction, the benefits of addressing this failure are likely to have economic benefits to UK and are therefore in scope in terms of the Green Book

21. For instance, if the Directive effectively inspires greater transparency, less information asymmetry and less corruption, UK extractive companies will benefit from the improved operating environment. With greater political and economic stability in the countries they operate in, UK extractive companies will be able to produce more consistently and

at a lower cost than under the status quo. Also UK investors will be able to make improved investment decisions.

22. Greater transparency around extractive companies will reduce the **information asymmetry** between investors and extractive companies, thereby ensuring a more efficient allocation of capital. Moreover, if investors are more able to make effective investment decisions, capital will be more efficiently allocated, to the benefit of the companies with the greatest growth prospects.

23. Knowledge of a company and its operating environment is important in helping those who engage with a company to more accurately assess the risk of company transactions, and therefore their own engagement with them. Not knowing a company's full profile means that there is a greater inherent risk of investors making sub optimal investments. This makes economic transactions/activities less attractive and hence less likely to go ahead or they will go ahead but at a higher cost or lower level. For instance, Easley and O'Hara (2004) find that companies which keep a greater proportion of their information private require a greater compensating return for the lack of transparency, i.e. they face a higher cost of capital.

24. In addition, when corporate information is not readily available, other parties must incur greater costs from conducting due diligence to mitigate this risk. They must, for instance, actively seek to 'profile' the company and also write, complete and monitor contracts. Therefore a lack of information will increase transaction costs, which can serve as a serious barrier to entry in the market, discouraging economic activity and potentially harming growth.

25. There is also a strong political/societal rationale to intervene on **international equity** grounds to assist disadvantaged people in developing countries by increasing accountability and therefore promoting good governance. Increasing good governance is likely to lead to improved social outcomes. Although the benefits associated with international equity accrue outside the UK (so are not strictly counted under Green Book guidance) this forms a major part of government's rationale for intervention.

POLICY OBJECTIVES

26. The aim of Chapter 6 is to raise global standards of transparency in the extractives sector by requiring companies to report publicly the payments they make to governments in all their countries of operation.

27. This is intended to improve accountability, reduce the space for corruption and other illicit activities, and ensure that citizens benefit appropriately from the extraction of their natural resources.

28. It is also expected to bring real benefits to UK extractives companies by improving their operating environments, as well as to UK investors by improving their ability to assess risk and make more effective investment decisions.

29. As such, Chapter 6 supports the Government's ambition for strong extractives reporting requirements and represents a significant contribution to the development of a global standard for transparency in these industries

30. The key requirements introduced by Chapter 6 are for EU listed extractives companies (mining, oil, gas and forestry) must report the payments they make to governments in all of their countries of operation. Reports must be prepared on an annual basis, and

(i) Be prepared on the basis of individual projects

(ii) Include all payments made in money or in kind, whether made as a single payment or a series of related payments, totalling over €100,000 (approx. £84,000) or more.

(ii) Disclose the total amount of payments made to each level of government, including national, regional and local governments, and state owned organisations.

(iii) Disclose the total amount per type of payment. Types of payment covered are: production entitlements; taxes levied on the income; production or profits of companies (excluding taxes levied on consumption such as value added, personal income taxes or sales taxes); royalties; dividends; signature, discovery and production bonuses; licence fees, rental fees, entry fees and other considerations for licences and/or concessions; and payments for infrastructure improvements.

31. There will be no exemptions to reporting, even where companies are operating in countries that prohibit disclosure in criminal law. It is felt that providing exemptions in these cases would diminish the effectiveness of the reporting requirements in the Directive and would provide an incentive for corrupt countries to implement such laws.

32. The amendments to the Transparency Directive published in November 2013, will now introduce this new set of reporting requirements for extractives companies.

33. The content of the report is fixed by the Directive. As such, there are limited areas within which the UK can define requirements. These limited areas, along with their possible associated costs and benefits, are explored in this IA.

34. The Accounting Directive, which introduces the same policy for large UK registered companies (whether or not they are EU listed) will introduce the requirement on 1 January 2015. A consultation was launched in May 2014 and the responses noted the potential differences in approached of the AD and TD reporting requirements. In general the responses from the civil society supported the early proposed early timeframes, whilst industry made clear its support for the reporting of such information, a few companies sought delays to the timeframe for one year in line with other Member States and the US. The decision to implement early was made independently of potential regulations in the US as the US reporting requirements have yet to be developed, and

therefore carry uncertainty with regards to the specific details and timing. With respect to alignment with other Member States, early implementation is largely driven by the international equity argument – by implementing early, the UK aims to promote accountability and good governance, leading by example to improve the operating environment in developing countries by fighting corruption.

Option 0:

35. Do nothing. This is an artificial construction representing a world in which the EU had not legislated in this area. In practice, the only discretion member states have is during implementation, as outlined in option 1 and 2. It is used solely for the construction of an EANCB for Option 1.

Option 1:

36. This option proposes implementing the Directive on 26 November 2015, the transposition date set by the Commission. Implementation on this date would require extractives companies to begin reporting any payments they have made to governments for financial years beginning on or after 1 January 2016.

Option 2:

37. This option proposes implementing the Directive early, by bringing regulations into force in December 2014 to apply to financial years beginning on or after 1 January 2015. Implementation on this date would require extractives companies to begin reporting any payments they have made to governments for financial years beginning on or after 1 January 2015.

Option 2 is our preferred option:

38. In the communiqué and declaration published following the G8 summit at Lough Erne, the Prime Minister, alongside other EU G8 members, committed to implementing the extractives transparency requirements contained within the Directive quickly.

39. He gave this commitment in recognition of the fact that these new requirements represent a significant step forward in fighting corruption in developing countries, and in helping to ensure that the citizens of those countries benefit from the huge sums of money that extractives companies pay their governments for access to natural resources.

40. As we also expect the Directive to bring benefits to UK extractives companies operating in resource rich countries, as well as to UK investors, early implementation will ensure that some of these benefits accrue as soon as possible. It is difficult to determine the extent to which reporting by UK listed companies alone would achieve critical mass in terms of promoting accountability and promoting good governance. However, it would allow investors in UK listed companies to achieve certainty earlier and so make more optimal investments.

OPTION 1

BENEFITS:

Benefits to citizens of developing countries:

41. By disclosing details of the payments they make to governments, extractives companies will be making significantly more information available about what is specifically paid by them to host governments in exchange for access to the country's natural resources.

42. Publicising this information at project level should make host governments more accountable to their citizens for the way in which payments are spent. Citizens and civil society will have far greater insight into what governments (local and national) are being paid by extractives companies. This will give them the information they need to help demand that their governments account for how the monies have been spent locally.

43. In the absence of an existing extractives reporting requirement, it is difficult to quantify the size of these benefits with any precision. However, many stakeholders have commented that increasing transparency around the payments made to governments is

likely to improve governance, reduce corruption and ensure that income from extractives companies is invested in citizens

44. There is also evidence to suggest that countries with greater extractives transparency are more attractive to investors. A 2013 study into the effect of the Extractive Industries Transparency Initiative (EITI) participation found that joining EITI (a voluntary global coalition of governments, companies and civil society working together to improve openness and accountable management of revenues from natural resources) is associated with an increase in the ratio of FDI inflows to GDP by two percentage points on average. This is significant given that the average ratio of FDI inflows to GDP in the sample of 81 countries studied was five percent (ibid.).

Benefits to UK companies:

45. Due to the nature of work in which they are engaged and their relative lack of mobility, extractive industries are more easily affected by unstable economic and political environments than other sectors. They are relatively immobile, given that they must locate themselves wherever minerals and energy deposits exist.

46. They therefore have a particular interest in improving governance, expanding economic opportunity and increasing political stability in their host communities.

47. As mentioned earlier, many stakeholders have commented that transparency around payments to governments improves governance, reduces corruption and ensures investment in local communities. Whilst these benefits are difficult to quantify precisely, there is a consensus among both industry and civil society around these effects.

48. According to a study by researchers at Harvard and Queensland universities, lost extractive industry productivity and costs incurred due to conflicts can be highly significant: “as a result of conflict, a major, world-class mining project with capital expenditure of between US$3 billion and US$5 billion was reported to suffer roughly US$20 million per week of delayed production in net present value terms.”

49. A report by the Corporate Social Responsibility Initiative at Harvard University also found that expanding economic opportunity in host communities can reduce risk, decrease costs of production, and increase profitability for extractives companies. It identified real and reputational costs of protests, work stoppages, boycotts and regulatory backlash where companies are not, or are not seen to be, investing in local communities.

50. As of July 2007, Royal Dutch Shell reported that 195,000 barrels of oil a day remained trapped in Nigeria, with a daily price tag for the company of nearly $16 million. Lack of economic opportunity, both real and perceived, is identified as one of the key factors contributing to violence and the disruption of operations in the region (ibid.).

51. The report also found that a more vibrant local economy can positively impact company bottom lines by reducing the cost of production inputs, which are materially affected by local economic conditions (ibid.).

52. To the extent that local individuals, communities and host nations are experiencing greater economic opportunity, companies' production costs and local and regional sales may be positively affected. A well-functioning host country market can provide access to a continuous supply of labour at prices well below expatriate packages, materials that need not be imported, and innovation in products and processes that are appropriate to local operating environments (ibid.).

53. In addition, creating a business environment where less bribery and corruption takes place creates a more level playing field for companies that do not take part in such practices, whilst an absolute reduction in the levels of bribery and corruption would increase the level of profits available to be paid to as dividends to company shareholders. This was supported by one company, which commented that "Transparency in conjunction with an appropriate tax regime allows all companies to operate on the same playing field. Open and accountable agreements are the basis for good governance and a kick starter for a significant reduction in corruption and bribery."

54. By being seen to be making significant contributions to the economy themselves, extractives companies can boost their reputation and social licence to operate. They can also take advantage of the greater political and economic stability and opportunity greater transparency can bring. The degree to which the increased transparency of payments will deliver such results is uncertain and unquantifiable. In response to the consultation Publish What You Pay noted that payment transparency has wide support among the investor community. This response highlighted the two groups of institutional investors representing trillions of dollars of assets under management that submitted to the US SEC in April 2014

55. It could be argued that if making these contributions is beneficial to companies then it would be rational for them to do it themselves, without government compulsion. However, companies may not do this in practice because of co-ordination failure. If any one company were unilaterally to declare payments then this may not be recognised by wider society, while simultaneously imposing reputation risk on the declaring company. However if firms took collective action then this culture change would be noticed and the benefits would be realised. Companies may find it difficult to co-ordinate this collective action due to imperfect information, transition costs and so on.

Benefits to UK investors:

56. The US Securities and Exchange Commission's (SEC) impact assessment for its own extractives transparency rules included comments from a range of investors who suggested that the information disclosed in the transparency report would benefit investors by among other things, helping them model project cash flows and assess political risk, acquisition costs, and management effectiveness.

57. Investors stated that the disclosures required have value to investors and can "materially and substantially improve investment decision making", namely by reducing information asymmetry and providing more security and certainty to investors as to extractives companies' levels of risk disclosure. This is particularly the case in countries where

governance is weak, as the resulting corruption, bribery and conflict can negatively affect the sustainability of a company's operations. Disclosure will therefore improve investors' ability to more effectively make investment decisions (ibid.).

58. Project level reporting means that investors can also better understand the risk profiles of individual projects within a given country, which may vary greatly depending on a number of factors such as regional unrest, personal interest by powerful government figures, degree of community oppression and environmental sensitivity. Unusually high signing bonus payments for a project may be a proxy for political influence, whereas unusually low tax or royalty payments may signal that a project is located in a zone vulnerable to attacks or community unrest (ibid.).

59. We do not have sufficient evidence to put a monetary value on the impact on risk and the required rate of return.

COSTS

Costs to business from reporting requirements:

60. The requirement to produce an annual extractives transparency report will result in both transition and ongoing compliance costs. These costs will differ between those companies which are will undertake the final reporting for themselves and for any subsidiaries, and those companies which will only be required to provide information to a parent who will report on their behalf.

61. According to the European Commission's impact assessment, conducted in 2011 (available online: http://ec.europa.eu/internal_market/accounting/docs/sme_accounting/review_directives/SEC_2011_1289_2_en.pdf), EU listed extractive companies will face set up (one off) administrative costs totalling €548 million, and recurring annual costs of €192 million (across a ten year timeframe this would be in excess of €2.4 billion). These costs are assessed in be in 2011 prices and assume a certain form for the US regulations.

62. The Commission derived these costs from detailed estimates it obtained during consultation (Annex 8 of its Impact Assessment). Unfortunately, much of the detail was

business sensitive and the Commission presented little disaggregated data, making it difficult to assess exactly how thorough companies were in reporting their own costs (for example, to what extent they considered staff training in addition to the more obvious staffing costs). Attempts to supplement this data with comparable British firm specific data via consultation ahead of the transposition of the Accounting Directive were ultimately unsuccessful (a point considered in more length below). Nevertheless, we are content that the European Commission was sufficiently diligent in undertaking its research for its figures to represent a useful approximation of an ultimately unknown quantity.

63. The European Commission has stated that there are 171 listed extractives MNCs (multinational corporations) in the EU. The London Stock Exchange publish an official list of all UK Listed companies across all sectors. Using their official database, it can be determined that80 extractive companies are listed on the London Stock Exchange. Using this as a reliable figure for the number of UK listed extractive firms, the UK share of EU listed extractive companies can be calculated. 80 firms as a percentage of the EU listed firms calculates the UK share to be 46.8%. Assuming these are typical, the same percentage of the total cost can be apportioned to UK firms.

64. However, out of the 80 UK listed extractive companies, 37 (46%) are also UK registered companies. This can be determined from the database. The compliance costs of these companies has already been accounted for under the Accounting Directive. The same logic applies to UK listed firms registered in other EU countries where those countries are also implementing the Transparency Directive early, though we for simplicity we can assume that they are not as there have been no announcements from other EU member states. . As the Accounting Directive will account for the 37 UK listed, UK registered companies, this leaves the number of UK listed (non-UK registered) companies to be 43 out of the 171 EU listed companies.

65. Overall, then, the UK share of the EU cost estimates can be estimated at 54% x 46.8% = 25.1%. That is, 25.1% of the extractives firms in the EU are listed but not registered in the UK. It is these firms that early implementation will affect.

Transition costs:

66. It is expected that extractives companies responsible for reporting will need to make changes to their existing financial reporting systems. It is likely that improvements or system upgrades are required to allow them to capture and report payment data at project level, for each type of payment, government payee, and currency of payment. This could include establishing additional granularity to existing coding structures, developing a mechanism to appropriately capture data by "project", building new collection tools within financial reporting systems, establishing transaction types to accommodate types of payment, and developing a systematic approach to handling "in kind" payments e.g. investing in infrastructure. Additional staffing may also be required, as well as relevant training for staff in order to carry out these reporting and compliance activities effectively. There will also be familiarisation costs involved in developing an understanding and interpreting the requirements in Chapter 6, and parent companies will are expected to incur costs in supporting their subsidiaries in understanding the requirements. Subsidiaries themselves will also incur costs of familiarisation and implementing new data gathering processes. These familiarisation costs have been included in the transition cost estimates.

67. However, many multinational extractives companies are already subject to reporting requirements in some jurisdictions, for example the EITI. Some also already report some of the information required on a voluntary basis. In these cases, they will already possess internal systems capable of recording at least some of the payments required under Chapter 6, and the changes they will need to make are unlikely to be as wide ranging or costly.

68. Using the approach outlined above, we can estimate the relevant transition costs imposed by the Transparency Directive at 25.1% x €548 million = €137 million. Using the current exchange rate of €1=£0.78, the total set up costs would therefore be £106.2 million in 2011 pounds.

Ongoing costs:

69. Once systems have been put in place to collect the necessary data, companies responsible for final reporting will face ongoing costs associated with the requirement to collate data from any subsidiaries within scope and produce an annual report. Subsidiaries will face on-going costs of gathering and providing data to parent companies to report.

70. As before, we estimate these ongoing costs at 25.1% x €192 million = €48 million. Using the current exchange rate of €1=£0.78, the total recurring annual costs would be £37.36 million annually (in 2011 pounds).

Wider costs

(i) Competitive disadvantage:

71. Whilst disclosing payments to governments will not give direct insight into the levels of turnover, costs and profits that an extractives company generates in a particular area, there could be instances when confidential business data could be revealed or can be deduced from such data.

72. Some companies have suggested that EU extractives companies would not be operating on a level playing field when compared with companies not caught by TD or AD, or with state owned companies, many of which have foreign operations.

73. Importantly, companies have not been able to produce any convincing evidence that disclosure of payment information negatively affects their ability to win contracts.

74. Furthermore, companies registered in the EU will have to comply with the same reporting requirements via the AD.

(ii) Costs arising from the lack of exemptions clause:

75. The Transparency Directive does not provide any exemptions to reporting, even where companies are operating in countries where disclosure of such information is prohibited by criminal law. Some companies believe that this could create a conflict in law and

result in increased legal fees or fines, loss of business, forced divestment and even criminal sanctions.

SUMMARY

76. Extending these costs over 10 years (2016 to 2025) and annualising, one obtains an EANCB of £40.0m. This represents the unavoidable cost imposed on business by virtue of transposing the Transparency Directive into UK law.

OPTION 2

BENEFITS

Benefits to citizens of developing countries

77. As with Option 1 except some of these benefits will be realised early

Benefits to UK companies

78. As with Option 1 except some of these benefits will be realised early

Benefits to UK investors

79. As with Option 1 except some of these benefits will be realised early

COSTS

Costs of reporting

80. The reporting costs incurred under Option 2 will be greater than under Option 1 due to implementation 11 months earlier. The main assumption used in this instance is that all firms will need to begin reporting a year early. The assumption is a conservative one when the effect of the EU wide transposition of the Accounting Directive on reporting costs for UK listed but other-EU registered firms reporting between August and December is considered as part of the counterfactual. As a result, the reporting costs of option 2 are likely to, if anything, represent an upper bound.

81. The impact of the transition costs of £106.2m have not been accounted for in this assessment, as companies would be subject to these costs 12 months later when the transposition date sets in. Unfortunately it is not possible to monetise this effect in a

way consistent with the other figures presented for this Impact Assessment, especially given the significant uncertainty around the exact time profile of transitional arrangements and the transition costs themselves. It is likely that the impact of bringing forward these costs by a matter of months would in any case be minimal.

Risks and assumptions

82. Estimates of the cost of reporting are based on the European Commission's impact assessment, conducted in 2011. It can be inferred from the more recent Government consultation of reporting costs (conducted in advance of the Accounting Directive's transposition and available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/341986/bis-14-1024-implementation-chapter-10-eu-accounting-directive-impact.pdf) that the European Commission's figures (particularly its transition cost figure) may well be significant overestimates (c.f. Annex A of that document). The distinction may have arisen from increased voluntary adoption of EITI reporting principles between 2011 and 2014. The Accounting Directive consultation invited views from industry on what the economic, legal and practical costs would be for UK listed firms caught under AD. However, It is difficult, to be more precise given the lack of responses to the domestic consultation, which received very few detailed quantitative responses.

83. In light of the difficulty reconciling the Commission's estimates with those presented in the Government's own consultation, this assessment has adopted the maximally cautious approach of using the Commission's much higher cost estimate estimates.

Wider impacts

Statutory Equality Duties

84. The Government has considered the proposed reforms in relation to its public sector equality duties under the Sex Discrimination Act 1975, the Race Relations Act 1976, the Disability Discrimination Act 1995, section 75 of the Northern Ireland Act 1998 and the

Equality Act 2010. The Government believes that no relevant issues arise from the implementation of this policy.

Small and Micro Business Assessment

85. The scope of Chapter 6 of the Directive extends only to those extractive companies which are (in this case UK) listed on a regulated exchange (i.e. the Main Market of the LSE and not the AIM). This restriction has the knock-on effect of excluding almost small and micro business (i.e. those employing 0 to 49 persons) when employment figures for subsidiaries are included. As a result, we conclude impact of this policy on truly Small and Micro businesses is likely to be negligible.

Environmental Impacts

86. Although this policy is around extractive industries, there are no obvious direct concerns in this area. Although this measure may lead to an increased level of output, therefore potentially increasing pollution, we assume that extractives companies will comply with existing environmental frameworks in the country in which they operate.

Social Impacts

Health and Well-Being:

87. No obvious concerns in this area.

Human Rights:

88. No obvious concerns in this area.

Rural Proofing

89. No obvious concerns in this area.

Sustainable Development

90. No obvious concerns in this area.

ONE IN TWO OUT STATUS

91. In line with the Better Regulation framework, two EANCBs have been presented in this Impact Assessment.

92. The first is an EANCB (£33.6m) for transposing the Directive on a copyout basis. We consider this cost to be out of scope for the purposes of the one in, two out (OITO) framework. As an indefinite regulatory measure, it is annualised over the full default appraisal period of 10 years.

93. The second EANCB (£33.6m) represents the *additional* burden of implementing the Directive early. We consider this cost to be in scope for OITO purposes (and as a regulatory IN). As a cost arising from early implementation, it is costed with reference to the first EANCB. Indeed, since the policy is being implemented precisely a year early, it is identical to the first (out-of-scope) EANCB.

ANNEX 1: Transposition Project Plan/Milestones

22 October 2013	Date the EU legislation was adopted
6 November 2013	Published in the Official Journal of the EU *http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:294:FULL:EN:PDF*
Dependencies and Issues	*The Directive includes Level 2 measures which the European Commission is required to adopt following technical advice from European Securities and Markets Authority (ESMA).*
Method of Transposition	*New secondary legislation and FCA rules*
26 August 2014	FCA consultation on Chapter 6
November 2014	RRC clearance for Chapter 6
1 January 2015	Country by country extractive reporting in force
April 2015	Final RRC clearance for rest of TD
May 2015	Lay regulations for the rest of TD
N/A	Expected date for transposition in NI/Scotland/Wales
26 November 2015	Expected date for transposition in Gibraltar

August 2015	Expected date for publication of guidance
26 November 2015	Planned date for notifying the Commission of transposition
26 November 2015	UK legislation enters into force
26 November 2015	Final transposition deadline (from EU legislation)