

The risks of trade finance

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Trade finance carries risks of its own, which the events of 2020 brought to light and which the following chapter analyses. They can be grouped into a few categories.

Documentary risk concerns fraud involving the documents themselves: forged bills of lading, fabricated inspection certificates, fictitious invoices. The principle of independence of the documentary credit, which obliges the bank to pay against documents that appear to be compliant, makes it vulnerable to well-executed forgeries. Verifying the authenticity of documents with the carriers and inspectors, now made easier by electronic platforms, is the main safeguard.

The risk of multiple pledging concerns goods pledged to several banks, each believing that it holds exclusive security. The frauds of 2020 relied largely on this mechanism, which the absence of a central register of pledges over goods makes easier.

Performance risk concerns the failure of the producer or seller to deliver the financed goods, particularly in pre-financing arrangements. Price risk concerns a fall in the value of the pledged goods, which reduces the bank's cover. Counterparty risk concerns the creditworthiness of the trader and of the final buyer. Country risk concerns transfer restrictions, expropriations and conflicts in the countries of the counterparties.

Compliance risk, finally, concerns sanctions, money laundering and corruption. A bank that finances a cargo destined for a sanctioned entity, or whose proceeds feed the corruption of public officials, exposes itself to prosecution and to considerable penalties, including in the United States when the transaction is denominated in dollars. Chapters III to V of this Part set out these risks in detail.

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Caution. Trade finance combines documentary risk and the risks of multiple pledging, performance, price, counterparty, country and compliance. The banks that practised it without rigorous verification of documents and goods suffered losses in 2020 running into billions of dollars.

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