

Trade finance: how a cargo of crude is financed, and how billions vanished in 2020

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Commodity trading is a credit business. Between the purchase of a cargo and payment by the buyer lie weeks in which the trader must tie up capital he does not have. The bank bridges that period against security that consists, at bottom, of paper. In 2020 it became clear how much depended on that paper being genuine.

1 The basic transaction

In the classical sequence the buyer instructs his bank to open a documentary credit in favour of the seller. The bank undertakes to pay against presentation of specified documents: bill of lading, commercial invoice, insurance policy, certificates of origin and quality. The seller ships, presents the documents and is paid. The buyer receives the documents and with them control over the goods.

The governing principle is strict compliance. The bank examines the formal regularity of the documents and their conformity with the terms of the credit. It does not examine the goods, the underlying contract or the good faith of the parties. The Federal Supreme Court has confirmed the principle: the bank had only to examine formal correctness and conformity with the conditions; strictness is the rule, and exceptions apply only to irregularities so insignificant that they can play no role.

The harshness is the point. A bank required to investigate the sale contract could not decide within hours, and the instrument would lose the speed that makes it useful.

2 The financing forms in practice

Form	What secures it	Principal risk
Documentary credit	the documents and the issuing bank's undertaking	document fraud; discrepancies
Transactional financing	a single identified cargo and its receivable	diversion; double pledging
Borrowing base facility	revolving inventory and receivables	overstated inventory; valuation
Pre-export financing	future production and offtake contracts	performance risk; sovereign interference

In each case the security is goods, documents and assigned receivables. None of it is worth anything if the goods do not exist or if the same goods secure several lenders.

3 2020: what went wrong

In the spring of 2020 several traders collapsed. Hin Leong in Singapore applied for a moratorium on 17 April. Others followed across Asia and the Gulf. The investigations exposed four patterns that now shape every credit assessment in the sector.

Multiple financing. The same cargo served several banks as security at once, because bills of lading were copied or issued more than once. Paper documents passing through many hands make this possible; no register existed against which a bank could check whether the document it held was unique.

Fictitious cargoes. Documents were presented for goods that never existed. Where the bank's security is a piece of paper and the paper is forged, there is nothing behind the exposure.

Concealed losses. Trading losses were hidden in the balance sheet over years, and financing continued on the basis of accounts that did not reflect them. Lenders relied on figures that had been constructed for them.

Concentration. A small number of banks held large parts of the market. When they withdrew, the effect fell on the whole centre and not only on the failed borrowers.

Losses from the 2020 cases are estimated at more than nine billion dollars. Several institutions left trade and commodity finance altogether, among them ABN Amro and BNP Paribas (Suisse).

4 The response

The industry's answer was partly technical and partly organisational.

- **Independent verification of inventories**, with inspection companies instructed directly by the bank and reporting to it, not to the borrower.
- **Central registers for bills of lading**, allowing a lender to check whether a document has been presented elsewhere.
- **Electronic bills of lading**, which make multiple issuance technically impossible where the platform is used by all parties in the chain.
- **Caps on single exposures** and on exposure to single commodities and corridors.
- **Audited accounts under recognised standards**, with lenders declining to rely on management figures.
- **Covenant packages** addressing inventory turnover and the ratio of hedged to unhedged positions.

5 What this means for the trader

The bar for being financed has risen and will not fall back. A trader seeking facilities today must be able to evidence, at any time and without preparation, what he holds, where it is, who else has an interest in it, and how the position is hedged. Systems that produce that evidence on request are now part of the cost of doing business, and the smaller houses feel it most.

There is a second consequence that is easy to miss. Because lenders now verify independently, the relationship between trader and bank has become less personal and more documentary. The old model, in which a credit officer who had known the family for twenty years could form a judgement, has receded.

6 What this means for the lawyer

The work is in the chain of security, and the chain is only as strong as its weakest link.

1. **Identify each link.** Assignment of receivables, pledge of goods, pledge of documents, security over accounts, parent guarantees, insurance assignments.

2. **Establish the governing law of each link separately.** The sale may be governed by English law, the pledge by the law of the place where the goods are stored, the assignment by the law of the assigned claim.
3. **Establish where each link is enforced,** and whether the forum will recognise the security as created.
4. **Check perfection requirements** in the storage jurisdiction — notification, registration, possession — because an unperfected pledge is worth nothing in the insolvency of the borrower.
5. **Model the insolvency.** Who takes the goods if the trader fails? The financing bank, the warehouse, the buyer who has paid, or the seller who has not been paid?
6. **Provide for fraud.** Representations as to the uniqueness of documents, undertakings not to pledge elsewhere, and the consequences of breach.

7 The systemic point

Trade finance is often described as low risk because it is short-term, self-liquidating and secured on real goods. That description holds where the goods exist and the documents are genuine, and it fails entirely where they are not. The events of 2020 showed that the risk in the product is concentrated at precisely the point where diligence is hardest: verifying the existence and the exclusivity of a cargo on the other side of the world.

For Geneva the episode had a further meaning. The financing cluster is the reason traders are in the city, and the retreat of several banks reduced it. The policy debate about how to keep commodity finance in Switzerland begins here, and it is more consequential for the centre than the tax discussion that receives more attention.

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