

What a trading house does: arbitrage, logistics and risk

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A commodity trading house buys raw materials where they are available and sells them where they are needed, organising transport, storage, processing and finance along the way. The business is often caricatured, although Geneva hosts much of it. This article describes what traders deal in, how they contract, where their margin comes from and which risks they carry between purchase and sale.

1 The goods and the contracts

Commodities traded from Geneva fall into three families. Energy covers crude oil, refined products, natural gas in liquefied form or by pipeline, coal, electricity and a growing range of transition products such as biofuels and emission certificates. Metals and ores cover base metals such as copper, aluminium, zinc and nickel, iron ore, precious metals and concentrates. Agricultural products cover grains, oilseeds and their oils, sugar, coffee, cocoa, cotton and fertilisers. *Le Temps* reported on 18 November 2025 that 58 % of Swiss commodity trading takes place in the canton of Geneva, with oil, fuels, ores, metals and agricultural goods as the main lines.

Every transaction rests on a sales contract fixing the goods, quality, quantity, price or price formula, place and terms of delivery, payment, allocation of responsibilities and dispute resolution. Delivery terms usually refer to the Incoterms of the International Chamber of Commerce (ICC), which determine the moment at which risk and cost pass from seller to buyer. The current edition, Incoterms 2020, was published on 10 September 2019 and took effect on 1 January 2020 with eleven rules, four of which (FAS, FOB, CFR and CIF) are reserved for sea and inland waterway transport. Contracts also contain force majeure clauses, sanctions clauses allowing suspension or termination once performance becomes unlawful, and arbitration clauses.

The price is rarely a fixed figure. It is usually expressed by reference to a market quotation, such as a futures settlement or an index published by a specialised agency, plus or minus a premium or discount reflecting quality, location and particular conditions. Because the final price is often known only after delivery, physical trading is closely tied to the financial markets where benchmark prices form. Payment terms then allocate credit risk between the parties. The documentary credit, under which the buyer's bank undertakes to pay against conforming documents, remains the classic instrument and is governed by the ICC Uniform Customs and Practice for Documentary Credits (UCP 600), in force since 1 July 2007.

2 Where the margin comes from

Practitioners call the trader's income arbitrage, in the economic sense of exploiting price differences. Geographical arbitrage buys where a commodity is plentiful and sells where it is scarce, paying off when the price gap exceeds freight and ancillary costs. Time arbitrage buys and stores goods for later sale, which is profitable when the forward curve is in contango, with future prices above spot by enough to cover storage and financing. Quality arbitrage blends crudes, refined products or grains to meet a more valuable specification. Form arbitrage transforms the commodity itself by refining crude, smelting concentrates or crushing oilseeds, which is why the large houses have acquired refineries, smelters, terminals and fleets.

Producers and consumers also pay traders a margin for taking over marketing, logistics and hedging on their behalf. Since margins are thin relative to volumes, profitability depends on the repetition of low-margin operations, on efficient organisation and on disciplined risk control. Volatile periods widen these spreads. Citing a McKinsey study, *Bilan* reported on 3 March 2025 that the sector's net profit had doubled since the pandemic to 104 billion dollars in 2022.

3 Hedging and its side effects

A move in market prices between purchase and sale could wipe out the margin, so traders hedge with futures, options and swaps traded on exchanges or over the counter. On buying a physical cargo, the trader sells an equivalent quantity of futures on the same commodity and buys them back when the cargo is resold. A fall in price in the meantime produces a loss on the cargo that the gain on the futures offsets, with the reverse effect when prices rise. What remains is basis risk, the gap between the physical price and the futures price, which is generally smaller and more predictable.

Hedging creates risks of its own. Exchange positions require margin deposits, which in volatile markets can demand large amounts of cash at short notice. The European Central Bank's *Financial Stability Review* of November 2022 found initial margins in mid-2022 roughly twice as high as at the end of 2021, with the TTF gas contract at 339 euros per megawatt hour at the end of August 2022. In a press release of 8 December 2022, Trafigura announced that it had raised its total credit lines to 73 billion dollars with around 140 banks. Over-the-counter contracts add counterparty risk. A physical position that fails to materialise as planned leaves the hedge itself exposed, which is why the large historical losses in the sector have often stemmed from unhedged positions or failed controls.

4 Logistics, documents and risk

Trading is as much a logistics business as a pricing one. An oil cargo is loaded at a terminal, carried on a chartered vessel, possibly stored and then discharged at the buyer's facility. Each step requires contracts, documents, inspections, insurance and payment. Chartering vessels through brokers is a core skill, because volatile freight rates decide whether a geographical arbitrage works at all.

Documents carry the transaction. The bill of lading issued by the carrier evidences receipt of the goods, entitles the holder to claim them on arrival and can be transferred or pledged as a document of title. Inspection certificates attest quality and quantity, while certificates of origin, customs papers and insurance documents complete the file. Payment under a documentary credit depends on these documents conforming, which is precisely the dependence that documentary fraud exploits.

Beyond price risk, the trader carries credit risk on both the buyer's payment and the seller's delivery, logistical risk from delays, damage and carrier default, and political risk from expropriation, export restrictions and conflict. Sanctions risk, which has become a major concern since 2022, is the sudden illegality of transactions already under way with targeted countries, companies or persons. Legal and compliance risk covers corruption, money laundering, sanctions breaches and failures of due diligence that can lead to criminal prosecution. Commissions paid to local agents are a particular point of vulnerability, since part of them can be passed on to public decision-makers. The large houses therefore require identity checks, written contracts and a justification for every commission.

Two recent crises tested these defences. On 20 April 2020 the May 2020 WTI contract settled at minus 37.63 dollars a barrel, according to the interim report of the Commodity Futures Trading Commission (CFTC)

published on 23 November 2020. Traders with storage capacity profited by buying cheap oil for later sale, while several others failed and some of those failures exposed fraud.

5 What to take from it

Price differences are the product. A trading house earns its margin from differences between places, times, qualities and forms of a commodity, together with fees for marketing and hedging services rendered to producers and consumers.

Hedging shifts risk without removing it. Derivatives protect the margin against price moves while creating basis, liquidity and counterparty risk, as the margin calls of 2022 showed.

Documents and intermediaries are exposure points. The reliance of payment on documents and the use of local agents are where fraud and corruption risk concentrate, which explains the weight that compliance functions now carry.

6 Sources

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