

Warehousing, collateral management and the control of goods

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Where commodities are stored before sale, in tanks, silos or metal warehouses, the lender's security depends on the control of the goods in storage. The traders and their lenders use collateral management agreements, under which an independent collateral manager, often one of the inspection companies, takes custody of the goods on behalf of the lender. The collateral manager verifies their quantity and quality, issues warehouse receipts and releases the goods only on the lender's instructions.¹ The arrangement gives the lender possession through the collateral manager, which satisfies the requirements of pledge law in many jurisdictions, including Switzerland.

The frauds of the last decade have shown the limits of these arrangements. In several cases, goods that the collateral managers had certified as present in warehouses turned out not to exist, or to have been pledged several times. The lenders then sued the collateral managers for their losses. The metal warehouse fraud uncovered in the Chinese port of Qingdao in 2014, in which the same stocks of aluminium and copper were used as collateral for several loans, was a turning point for the metals trade, in which the traders of Zug are strongly represented.² The practitioner who structures a financing secured by goods in storage must verify the reputation and the insurance of the collateral manager, the terms of its liability, the procedures for the inspection of the goods and the rights of the lender in the event of a loss.

1 Notes

1. HFW, "Collateral Management and Stock Monitoring Agreements", Commodities briefing, December 2020, hfw.com: a collateral management agreement is a bailment agreement between borrower, lender and an inspection company acting as collateral manager, which

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takes possession of the financed goods, attorns to the lender, stores, secures and monitors them, issues warehouse receipts to the lender and releases the goods only on the lender's instructions. The liability of collateral managers for missing goods is not covered by this source. ↩

2. South China Morning Post, "Qingdao Port says 400,000 tonnes of metals involved in financing fraud", scmp.com: about 300,000 tonnes of alumina, 70,000–80,000 tonnes of aluminium ingots and 20,000 tonnes of copper; the same metals suspected of having been pledged for loans at several banks. Global Trade Review, "Qingdao's legacy", 7 March 2017, gtreview.com: international losses of more than USD 1 billion; exposure of Citi, Mercuria, Standard Chartered, HSBC, Glencore and Trafigura; Barclays and Deutsche Bank exited commodity trading in China and Trafigura exited metals warehousing there. ↩

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