Opinion **The Commodities Note**

Unseen risks of commodity trade finance

The Hin Leong collapse has exposed deeper issues in financing raw materials trades

A seismic shift is needed in how banks approach and assess the black and white in trade finance © REUTERS

Baldev Bhinder APRIL 29 2020

"Where did it all go wrong?"

It's a question some of the world's biggest trade finance banks will be asking themselves after the collapse of Hin Leong Trading.

Coming on top of the crisis at Agritrade International, the sector has about$5bn of exposure to two ailing commodity traders, both based in Singapore.

While there is temptation to look at the downfall of Hin Leong in particular as an oil specific issue — a punt on prices to go up when in fact they crashed— commodities lawyers like myself will tell you that misses the deeper issues in trade financing exposed by this crisis.

Faced with shrinking arbitrage opportunities in the physical market, modern day trading is a highly leveraged activity — a race for liquidity through financing by any means, banks, alternate lenders, hedge funds, family offices, crowdfunding — you name it.

What is funded are some fascinating trade structures as documents are passed forwards, backwards and sometimes in circles — all in pursuit of credit and liquidity.

Trade financing can come in many forms. For companies with strong balance sheets, they have access to the most secured form of financing through letter of credit (LC) arrangements where a bank pays a supplier on its behalf on presentation of trade documents.

Where a company doesn't have enough financing, it sometimes seeks to rely on the LC of its end buyer in a back-to back trade to then pay its supplier.