



KEY ISSUES IN TRADE FINANCE

By **Sam Fowler-Holmes**, Partner at Sullivan & Worcester UK LLP and ITFA Emerging Leaders Committee Member

As the trade finance industry emerges from the pandemic-dominated start to this decade, focus is inevitably turning to identifying the lessons learnt and the issues that will (continue to) dominate the industry over the next few years. There are a multitude of possible issues that could be discussed, each of which reflect the varied nature of the challenges facing the industry and the progress being made by the industry to meet such challenges. However, there are four issues that have been particularly prevalent over the past couple of years and which merit particular discussion.

Fraud continues to be a fundamental part of the ongoing perception of trade finance as a high-risk industry. Although far from a new problem, a number of high-profile cases of fraud (or alleged fraud) during the pandemic placed attention firmly on the fraud risk within trade finance transactions. This was recognised by the UK regulators in their 'Dear CEO' letter dated 9 September 2021 which noted the "*high-profile failures of commodity and trade finance firms*" during the preceding 18 months and stated that there was "...often insufficient focus on the identification and assessment of...the potential for fraud" by trade financiers.

While it may not be possible to entirely eliminate fraud risk, it remains important, particularly in light of the regulators' scrutiny, to ensure that appropriate risk mitigation steps are taken. This includes focussing on client and transaction due diligence and monitoring (both before and during the transaction), good structuring and using appropriate and well-drafted documentation.

The second issue, digitalisation, offers potential solutions for some aspects of trade finance transactions that can be exploited in fraudulent ways. A clear example of this can be seen in the development of an electronic trade finance registry in Singapore. This is intended to provide a database of trade transactions that can be checked by trade financiers to avoid double financing fraud (among other things).

Although digitalisation of the industry was well under way pre-pandemic, the challenges posed by global lockdowns has undoubtedly accelerated the process. Use of electronic signatures and signing platforms appears to be more prevalent and there is increased focus on moving away from paper documentation to electronic equivalents. The UK Law Commission's proposed Electronic Trade Documents Bill would, if enacted into English law, be a significant positive step towards recognising electronic equivalents of a range of important paper trade documents, including bills of exchange, promissory notes and bills of lading. While digitalisation is undoubtedly the future for the industry, expect further challenges along the way.

Sanctions has once again dominated discussions this year. Although part of everyday life for the trade finance industry, the scope of the sanctions imposed in light of the war in Ukraine, and the speed of implementation, has posed unique challenges. The extra-territorial nature of certain sanctions, particularly those imposed by the US, creates an extensive matrix of overlapping and occasionally incompatible sanctions laws and regulations which the industry is tasked with navigating. This has resulted in many trade financiers and traders reviewing the terms of their documentation, seeking documentary protection against the possible consequences and impact (both direct and indirect) of complying with both sanctions and internal sanctions policies and procedures. As understandable and prudent as this may be, caution does need to be exercised to avoid inadvertently undermining the very nature of the arrangements being documented. This is a point that



ICC has raised on several occasions in the context of sanctions clauses and trade finance-related instruments.

ESG rounds out the list of issues, remaining a permanent fixture on the list of priority topics for the majority of participants in the industry. Challenges remain around the lack of standardisation and harmonisation in the area, an issue recognised by the UK government when publishing its Greening Finance paper in October 2021. However, headway is being made, and the range of materials now available from institutions such as the Loan Market Association and the Chancery Lane Project provides a framework for documenting ESG-focussed facilities. There are also a number of industry initiatives, including the formation of ITFA's ESG Committee last October with the objective of continuing to develop and promote ESG in trade finance.

A current criticism being raised is that trade financiers are not setting appropriate targets and performance indicators, tailored to the circumstances of the specific customer in question. It is important that trade financiers work with their customers in order to set reasonable, progressive and customer-focussed targets and to outline a clear process for monitoring and assessing attainment of those targets. By doing this, trade financiers will not only advance the intended ESG-objectives of their customers, but also mitigate the risks of 'greenwashing' and 'social washing' which loom large in this area.