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Analysis: Banks nervous over fraud losses as Singapore oil traders collapse

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Banks are being urged by regulators not to withdraw financing for Singapore's beleaguered commodities trade sector, despite a string of high-profile company collapses and allegations of fraud.

The city state's oil trading industry has been rocked by the sudden downfall of Hin Leong. Founded in 1963, the company grew to become one of Asia's largest fuel trading houses, until founder and chairman Lim Oon Kuin revealed to investors in April it had suffered US$800mn in undisclosed losses in the futures trading market. He added that oil set aside as collateral for lending had also been sold.

Just over a fortnight later, news emerged of difficulties at ZenRock, another of Singapore's independent fuel traders. HSBC filed a court application to have the company placed under judicial management, while accusations of fraudulent activity led to a police raid on its Marina View headquarters.

Though Hin Leong and ZenRock's demise was propelled by a historic crash in oil prices and the Covid-19 pandemic, concerns have not been limited to the fuels sector. Notably, in March, lenders were **left with exposures of US$600mn** (https://www.gtreview.com/news/asia/analysis-little-hope-for-banks-caught-up-in-agritrade-collapse/) after the collapse of commodities trader Agritrade.

With banks at risk of having to write off loans – particularly where single trades were financed several times over – firms are finding it increasingly difficult to access fresh lines of funding.

"Financing is effectively coming to a halt across commodity types," says Baldev Bhinder, managing director of Singapore law firm Blackstone & Gold. "I don't think that is helpful for anyone – the banks or the economy."

"The oil crisis has sucked up liquidity from the market, and cumulatively the banks appear to be quite jittery in their lending patterns," Bhinder tells **GTR**.

Regulators in the country have sought to reassure lenders that the oil trading sector remains resilient, despite the twin pressures of low oil prices and a significant decline in global demands.

The Monetary Authority of Singapore (MAS) is urging banks not to take a blanket approach to the sector, and continue lending wherever safe to do so.

"In their credit risk management, banks are expected to apply judicious credit assessments on individual borrowers and not rely on broad-based sector de-risking," a spokesperson for the regulator tells **GTR**. "We note that banks in Singapore continue to lend to firms in the oil and gas sector."

The plea follows an MAS statement issued on April 21 reminding banks "not to de-risk indiscriminately".

But for banks active in the country, the situation is not necessarily that straightforward. A source familiar with the Hin Leong collapse says some banks are already responding by carrying out a review of how their commodities facilities work across the globe.

"You learn a lot from a fraud crisis," says the source, who requests not to be identified. "There's been a temporary halt on everything except the most necessary lending – not because banks can't afford to fund traders but because a lot of these shocks may not have worked their way through the supply chain, and so there are still worries about companies' financial health."

Of the international banks with exposure to Hin Leong, the three largest are believed to be HSBC, ABN Amro and Société Générale.

ABN Amro said in its Q1 financial results that "a potential fraud case in Singapore" was one of two exceptional files accounting for €460mn in impairments.

"The corporate loan book is diversified and exposures to high-risk sectors such as offshore, diamonds and trade and commodity finance have been reduced in recent years, although more de-risking is clearly necessary," it said.

A bank spokesperson says it never discusses individual client situations nor discloses client names, but adds a review is ongoing into the activities of its corporate and institutional banking activities.

HSBC's Q1 filings report that its expected credit loss was US$3bn, a year-on-year increase of US$2.4bn, due to "a significant charge related to a corporate exposure in Singapore" as well as the impact of coronavirus-weakened oil prices. The bank declined to comment when contacted by **GTR**.

A spokesperson for Société Générale confirms it is a lender to Hin Leong, but says it has no exposure to ZenRock. They add the bank "will remain committed to the trade commodity finance sector, including in Asia".

What went wrong?

Though the initial impetus for Hin Leong's collapse came from its admission of undisclosed losses, brought to a head by the oil price crisis, the source says several examples of fraudulent practices have since emerged.

They say it is now apparent the company inflated its figures and built up leverage by creating fake trades alongside its legitimate activity.

"We've also seen multiple sales of the same cargo," they add. "You end up with a bunch of banks all trying to lay claim to the same assets, like oil that's still in storage tanks. In some cases, these sales are fictitious, where the cargo doesn't exist in the first place."

Hin Leong has since ceded control to PwC. Its exposure to HSBC reportedly stands at an initial US$600mn, with ABN Amro lending US$300mn and Société Générale lending US$240mn. Local banks DBS, OCBC and United Overseas Bank are exposed by around US$680mn in total.

In the case of ZenRock, the company issued a statement shortly after the Hin Leong incident saying it was not facing financial difficulties itself, despite the oil crisis and pandemic. It claimed to be profitable while dismissing rumours it was "under statutory restructuring/insolvency protection".

However, in early May, it emerged that HSBC had applied to Singapore's High Court for the company's management to be removed. The request was granted last week, despite efforts by ZenRock to restructure liabilities itself.

According to *FT* reports, HSBC's court documents included allegations of "dishonest practices" and "shams". Examples included the issuance of duplicate invoices, enabling ZenRock to raise funding from multiple lenders for the same transaction.

One incident cited in court documents was the use of a letter of credit to facilitate the purchase of nearly 1 million barrels of crude oil from Azerbaijan's Socar, for sale to Total. HSBC says it expected to receive a deposit from Total, but when no funds arrived it discovered the payment had already been made to the Bank of China in order for ZenRock to pay off another loan.

The court documents add that these "extremely suspicious" practices came to light after ZenRock was unable to raise fresh financing.

HSBC's filing added: "The company's conduct displays a wanton disregard for its contractual obligations and a willingness to fabricate documents in order to support its attempts at raising financing."

For Blackstone & Gold's Bhinder, such collapses may be triggered by events such as the oil and Covid-19 crises, but should not be viewed as unique to the fuels industry. Instead, banks should pay closer attention to financing arrangements sought by commodities trading houses across the board.

"If you look across the many defaults over the years, they cut across different commodity types and the common theme tends to be an over-concentration of liquidity in the hands of a few select trading companies," he says.

"Once that liquidity is drawn out of the market, for micro or macro reasons, that's where a lot of things unravel.

"Some of the trades are commercially questionable in the first place. As long as the music plays, no one is going to find out, but the problems happen when there is a break in the chain. Then, two or more banks show up with the same claim, that they haven't been paid."

What's next for banks

For banks caught between pressure from regulators to keep financing commodities trade and expectations from boardrooms to cut exposure to risk, there are steps that could be taken.

Eric Chen, investment director for trade finance at Singapore-based asset management firm EFA Group, says lenders should respond by "strengthening their due diligence, collateral monitoring and management practices so as to plug the loopholes that may have been exploited by these three commodity traders".

Chen suggests banks consider carrying out physical site visits or spot checks, for example when providing inventory finance for oil products in a tank terminal.

They could also ensure majority shareholders or management have “skin in the game” by requesting personal guarantees, such as private assets they hold. Chen adds that EFA’s rigorous approach to underwriting helped it steer clear of any exposure to the Hin Leong, ZenRock and Agritrade defaults.

For Bhinder, banks should “start asking the difficult questions to their borrowers”. He says lawyers investigating cases tend to probe whether trades are commercially justified, how reliable firms’ balance sheets are, and if there is any likelihood of duplicate trades.

Those questions would be better served if raised while on-boarding new customers, rather than after wrongdoing has already emerged, the lawyer says. “I understand the pressure of a deal scenario, they have to do that quickly, but there must be a better way of testing balance sheets and understanding trade flows,” Bhinder adds.

“That doesn’t mean banks should stop carrying on financing; the world needs financing to go on. We just need to be a bit more sensible and sustainable about it. If you finance someone to the hilt by a checklist it’s not really sustainable.”

Looking further ahead, Jean-François Lambert, founding partner of consultancy firm Lambert Commodities, says it is too early to say whether banks are likely to hasten de-risking from Singapore’s commodities market.

“Clearly Singapore needs the banks and especially international banks to keep financing commodity trades, which is a key sector for the city state,” he tells **GTR**. “For now they are in the middle of the storm, and it is rather difficult to undertake pulls-out unless for compelling reason such as frauds.

“Banks should stand by their customers in these difficult moments – and they probably do.”

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