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Fraud prevention in trade finance – lessons learned and lessons forgotten

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Previously published by Finance and Credit Law

Trade finance, the statistics will tell you, has an enviably low rate of loss – making it an attractive asset class, increasingly admired by private credit and other non-bank financiers despite a slow but steady retreat by many banks that had underwritten global trade for decades.

Global merchandise trade in 2025 exceeded \$35 trillion with around half of that figure requiring some form of trade finance. The attraction in being part of that business lies in part in the mature nature of the financial products and the legal structures and security packages that support them, much of it governed by English law whose judiciary carefully monitor the impact of commercial changes and market behaviour and make subtle changes in the law to keep it relevant and useful to users.

Receivable finance structures and trade debt receivables have seen a boom in traditional and new providers of finance, including online offerings aided by sophisticated credit risk and technology, as well as a mature trade credit insurance market. The countless structures and programs are based on sound and tested legal and economic building blocks .

Understanding why those legal building blocks are in place and how they should operate is the key to reducing the risk of loss and fraud. Fraud is an unwelcome guest at the trade community table. Trade and trade finance enjoy a rate of return which factors in a degree of

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appreciated risk, which is managed by a combination of legal and economic levers. Fraudsters familiarise themselves with the risk parameters within which honest traders and financiers operate and look for weaknesses in the way they operate – familiarity, complacency, and slack due diligence – and exploit those opportunities.

The basics in terms of establishing a sound legal base for lending against trade receivables are well known to the experienced market participant. Establishing that there is evidence of real underlying goods and services, understanding the contractual mechanics by which the trade debt becomes due and owing, satisfying itself that the seller has the legal right to transfer the debt – these are the basic groundworks for any receivables-based funding. Add to that gaining confidence that any security package is valid and enforceable in any relevant jurisdiction, and ensuring that any credit insurance cover is a good match for the lending/financing risk, and you have the starting point for a profitable and well risk-managed financing.

If goods are financed rather than simply the receivable arising on their sale, then establishing that the goods either exist or that the borrower has a clear path to ownership and possession, which will coincide with the financing, is the obvious starting point. Taking care to check that any security over goods is valid and enforceable in the “lex situs” – the law of the place where the goods are situated from time to time, and that they are adequately insured, is equally important.

Anyone who has come face to face with a market standard form of receivables purchase or other receivables financing agreement for the first time may well have been struck by the length and apparent complexity of the legal drafting, much of it based upon an appreciation of the combination of statutory and common law developments which have shaped the market documentation we use. However, the basic mechanics of that documentation and the endless “boilerplate” provisions are all there for a reason. The agreement will need to set out clear invoice processing and purchasing rules. Whether whole book or selective in nature, the financing will describe how receivables qualify to be financed. The agreement will describe any recourse events or repurchase obligations (taking care not to imperil any “true sale” status which the transaction needs to achieve. Rules for recognising and accounting for dilution of the receivable will be explained. A range of representations, warranties, undertakings and covenants will set boundaries within which the seller must operate throughout the duration of the facility with carefully weighted triggers. The agreement will also set out how notices of assignment are executed and served on debtors and how any security is to be perfected and/or registered.

Given proper due diligence on the borrower at the outset and carefully prepared documentation, a lender is in the best possible position to avoid being the victim of fraud. However, experience has shown that few lenders lend to enterprises that are set up to defraud. In reality, most modern-day fraudsters start out as relatively honest borrowers who fall prey to the temptation of easy, fraud-enabled money when trading conditions take a turn for the worse.

The methodology of fraudsters is to a large extent unchanged over decades – only the technology which enables (or exposes) it has changed dramatically. Wholly fictitious goods and services and fictitious invoices are the most commonly used method in the fraudster's playbook. A borrower which has a history of high-value transactions and a reputation for enabling a trusted supply chain will likely be trusted to continue that genuine trade even when its business has faltered. So called “end of life” frauds, where the invoices and trading levels reported to lenders remain (or exceed) previous levels, masking a financial performance that would inevitably have breached the borrower's covenants, happen because lenders become lax in the performance of ongoing due diligence and cross-checks. Many of the Singapore frauds in 2019/2020 fell into this category.

Duplicate or pre-settled invoices which are financed even though the debtor has already paid or received whole or partial forgiveness of the debt can sometimes take time to emerge because, after maturity and a supposed credit chasing process, the failure to pay may go through an insurance claims process before the breach of the financing agreement or outright fraud comes to light. With the collusion of a buyer (real or fictitious), over-invoicing to inflate the amount received by way of an advance rate from a lender is another method with a potentially slow discovery period. Other buyer/seller collusion methods include knowingly diverting a payment destined for a collection account or an account which the lender is monitoring so that the debt continues to present (at least to the lender) as unpaid. Covert “side-letter” dilution of debts by the seller or the offering of back-door discounts to buyers is another favoured method used as sellers seek to maximise financing for a dwindling sales book.

Multiple pledging of goods, where the goods (rather than invoices) are being financed, is the other favoured method – though difficult to pull off if the goods are at sea, as lenders will likely seek original shipping documents. Multiple pledging of warehoused goods where no original documents are being tendered is an easier fraud to accomplish.

In each case, opportunities to catch a pattern of fraudulent activity at an early stage before the fraudster becomes emboldened to continue or increase the regularity of its fraudulent

acts. If the loan agreement has been thoughtfully prepared to trigger alarms when a borrower's conduct goes off the rails, then multiple breaches of the financing agreement and tell-tale signs of those breaches. Failure to complete audited accounts on time or deliver periodic management accounts may indicate chaotic internal accounting or conscious revision of transactions to sanitise them for external inspection. Increases in directors' loans may also indicate an inability by owners to obtain the usual lines of credit.

The period between 2019 and 2020, as the world was rocked by COVID and its disruption of global trade, saw significant losses, some of which were at least attributable to "end of life" fraud in major companies which had been multi-banked. The Singapore trade finance market saw a major share of those losses. However, signs of what was to come had appeared as early as December 2018 when [Coastal Oil's bankruptcy exposed fraudulent action by the company's former CFO](#) and others who created fake sales contracts and invoices to persuade banks to advance funds under receivables financing arrangements. The scheme involved over \$340 million of loans obtained by deceiving its bankers between 2017 and 2018.

The interruption to normal trading activity, which the pandemic caused, pushed a number of traders who had been engaging in similar schemes over the edge of a financial cliff. The façade of success that [Singapore-based tycoon Lim Oon Kuin](#) of Hin Leong Trading was able to maintain saw multiple banks duped into advancing funds in what ended as a \$3.5 billion collapse, where HSBC alone took a \$111 million hit as a result of the presentation of forged or fictitious documents. Hin Leong, a once-successful trading company, was brought to its knees as it tried to stave off margin calls and maintain cash flow in a dire market situation.

Trade finance fraud has a far wider impact than just the financiers immediately exposed to the losses. Retrenchment by some banks and non-bank lenders inevitably follows major losses. Regulators double down on scrutiny and reporting requirements. The real victims are often those at an SME level who trade honestly but are met with an ever more sceptical reception by their banks and other financiers.

How then can financiers avoid the consequences of fraud? It may seem trite to say that prevention is better than cure, but in the case of trade finance fraud, that is undoubtedly true. The fungibility of money in the global trade system means that once funds are disbursed, they are likely to be consumed rapidly by a third party untouched by the borrower's fraud and, as a matter of law, probably beyond the reach of any subsequent recovery efforts. Indeed, the spate of Singapore trading company failures gave rise to multiple litigations,

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which saw the various participants (often innocent parties in the trades) fight it out to make recoveries from one another. Good news for the lawyers, and often the impact of those innocent parties pushing at the boundaries of the law to obtain a meagre recovery and obtaining judicial determination has the unintended consequence of making the trading and finance environment just a little more complex and unattractive for lenders. In the long term, everyone loses.

It might be expected that lessons learned from such a significant list of losses as those in the Singapore market (in excess of \$5 billion) would prevent future losses on a similar scale. However, just 2 years on, the TNT Metals fraud saw a major trader lose \$600 million in a fake Nickel scam. The collapse of Israeli fintech Vesttoo exposed a forged letter of credit scheme, which cost major insurers who relied on them over \$4 billion. Two major US companies associated with the US auto finance and automotive supply sector, First Brands and Tricolor, saw lenders exposed to billions of dollars in losses after both companies raised financing against fake transactions and documents. Hidden debt, off-balance sheet financing, and a lack of understanding of the sector's supply chain pressures caught some financiers off guard.

So what has the financing industry learned from this series of failures? In short, nothing that it had not already learned (and in some cases forgotten) from earlier frauds. The basics of trade finance practice, done well and consistently throughout the lifetime of a relationship, could and should have prevented many lenders from being forced to absorb heavy losses. The prolongation of business life for some of the companies described above may have given some more observant lenders the opportunity to exit before the music stopped. Those who were blindsided are still licking their wounds.

Great pre-funding credit analysis lies at the heart of much of a successful and de-risked trade financing relationship, of course, but the hard work in keeping that relationship on track must go far beyond the credit committee decision and the KYC and AML checks that are now a key part of any lending decision. Regular customer visits (which of course became impossible during COVID), along with ongoing credit analysis with careful choice of the available software in the market, are essential.

The use of technology to check invoicing and stock patterns, much of it aided by AI developments, can help lenders keep a constant reality check, however large or small the borrower may be. Understanding how the carefully drafted legal covenants in the financing agreement should be used and having a sensible strategy for testing them (something that may yet be beyond AI) is also important.

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Above all, understand your borrower, notice behavioural changes, and be curious!

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