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The complex global commodities financing supply chain is continuously evolving. In navigating this risk landscape, stakeholders can encounter risks in all directions. There's operational risk to physical inventories, credit risk with counterparts, political risk associated with the resetting of trading alliances, and technology risk associated with the exploration of blockchain/shared ledger applications. Fraud risk remains ever present and increasing, with losses in the metals sector being at the core.

Experts reported peak levels of storage for metals and concentrates in 2019. Supply chain intermediaries compete to add value to clients by maintaining large volumes of stock to enable 'just in time' delivery to clients. Increasingly limited storage space now carries a premium price tag across Europe and the US. These pressures are causing businesses to divert their storage away from their established partners - entering new environments that can increase the likelihood of fraud.

Hiding behind the veils of distance, time, custom and language, fraudsters will seek to elude detection and make financial gain through ever evolving fraudulent schemes.

Why should commodity fraud be on your risk radar?

Sparked by the Qingdao scandal of 2014, in which penalty fines in the region of USD 3 billion were attributed to fraudulent warehouse certificates pledging metal as collateral for multiple bank loans, commodities fraud and misappropriation have rapidly escalated up risk agendas.

In the wake of the Qingdao fraud case, a succession of further scandals involving fraudulent commodities documentation prove that international trade continues to attract determined fraudsters. Subsequent cases have involved issues with authenticity of warehouse receipts, with losses ranging from approximately USD 32 million to USD 300 million.

While the first party impacts can be severe, the ongoing financial and operational impacts can resonate across entire supply chains, bringing trade to a standstill.

"As supply chains continue to evolve and be disrupted, commodity houses and banks are increasingly encountering new risks as they engage with new counterparts in new jurisdictions where controls in emerging markets can be less mature."

Joel Sulkes, Practice Leader, Global Financial Institutions, Aon

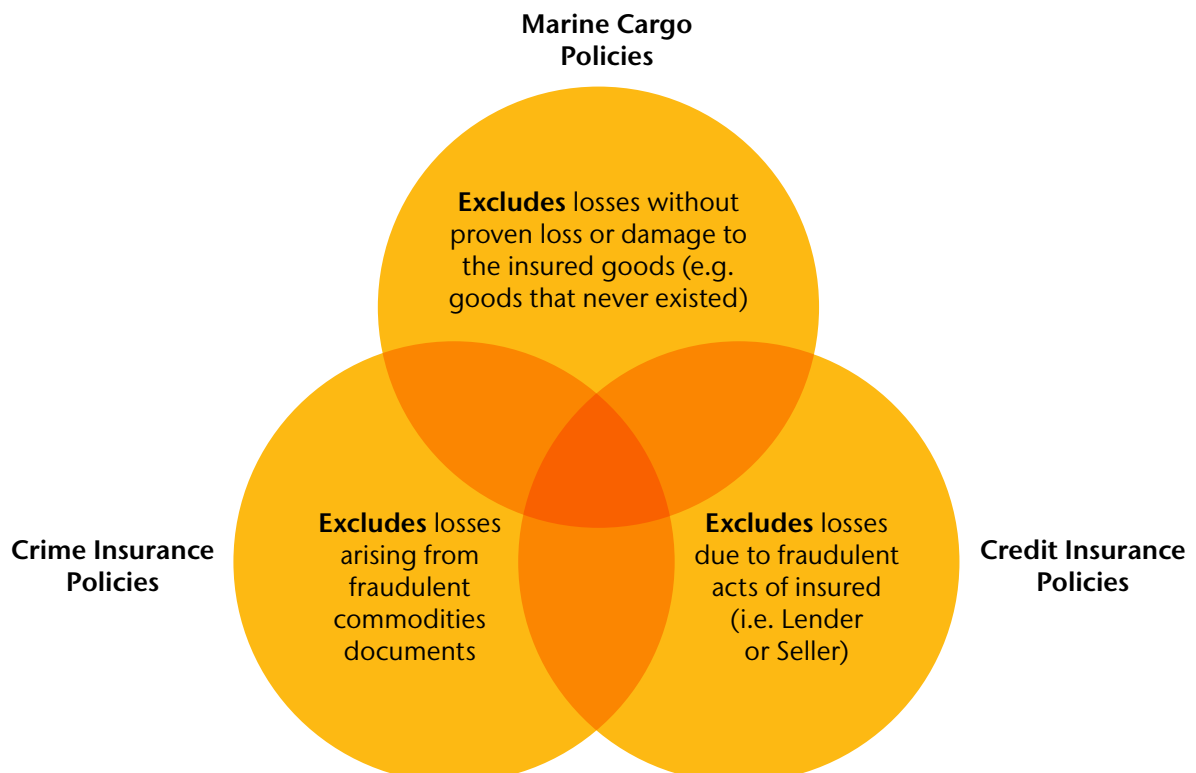
Managing commodity fraud risk – insurance products’ closing doors

Historically, marine cargo insurance policies have provided cover for physical loss of or physical damage to the goods during transit, storage in the ordinary course of transit and stand-alone storage. In the Qingdao case, most insurance claims were made under marine cargo policies, but ongoing claims for natural catastrophe (floods and storms), fraud and misappropriation have hardened the cargo market. Marine cargo insurers are now looking to restrict, sub-limit, or even remove cover from their policies, but demand for effective insurance remains high.

“With commodity storage at an all-time high, insurers are reaching their maximum exposure levels and securing coverage for commodity risks through a marine cargo policy is increasingly challenging. For financial institutions in particular, marine cargo coverage often does not extend far enough as it specifically does not include fraud risks of goods that do not exist.”

Walle Romijn, Account Manager – Commodity Trade, Financial Institutions, Aon

Other traditional insurance products also fall short of covering this exposure. Credit Insurance excludes losses due to fraudulent acts and crime or fidelity insurance typically excludes external fraud linked to commercial documents utilised in the commodities industry, such as bills of lading, shipping documents and warehouse receipts.



In need of another risk transfer solution, financial institutions and trading houses are evaluating alternative coverage.

“Providing financial institutions with innovative risk transfer solutions addressing the convergence of credit, marine, and financial lines markets is critical when managing commodities fraud risk.”

Murray Wood, Head of Financial Specialties - Asia, Aon

Moving forward – the evolution of coverage

Although traditional fraud policies have historically disappointed by excluding commodities documents, demand for effective insurance remains high. Recent innovation in the insurance market is giving financial institutions and trading houses new opportunities to benefit from bespoke document fraud coverage.

Where coverage gaps exist across standard credit, marine cargo and comprehensive crime insurance policies, commodities documentary fraud insurance is a valuable operational risk management tool. Aon’s proprietary Commodities Documentary Fraud (CDF) insurance was established in the London market to respond to this coverage gap.

CDF insurance indemnifies financial institutions for:

- Direct financial loss sustained due to purchasing, acquiring or relying on any document which proves to be forged, counterfeit, fraudulently altered/obtained/created, or contains a material misrepresentation
- Direct financial losses where the physical asset does not exist or the insured is unable to assert rights of ownership

The cover is applicable across all commodity classes (i.e. energy, metals, softs) and can also apply for fraud by agents, which is particularly important for financial institutions involved in a long chain.

Looking ahead – a world of opportunity

“Knowing your counterparts and understanding the control and mitigation landscape is critical as it pertains to physical exposure, loss to inventories, fraud or payment risk.”

Joel Sulkes, Practice Leader, Global Financial Institutions, Aon

Taking a holistic view across the various insurance programs that bear on physical commodity inventories therefore becomes essential. Financial institutions and trading houses are likely to benefit from reviewing the interplay of various insurance programs to ensure coverage both responds and remains cost-effective.

“Following decades of commodities document fraud being viewed by most underwriters as uninsurable, market evolution has created opportunities for firms to review their exposures and reset their risk transfer strategies.”

Adrian Smith, Executive Director, Global Broking Centre, Aon

By working with a leading global broker that is able to leverage insurance capacity across different regional markets, stakeholders in the commodities supply chain can secure access to increasing amounts of capacity being cultivated in the market with competitive terms and pricing.

The Aon difference

Aon’s specialist teams are focused on helping financial institutions make informed decisions for commodity document fraud risks. By actively engaging with markets, our teams are able to explore the scope of products available and tailor solutions for clients.

By leveraging our global scope and position in the market, Aon can measure different geographic markets against each other and use these insights to access insurance capital and capacity. As one market retrenches, opportunities arise elsewhere, and our global teams are in a position to provide responsive advice and action.

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About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

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