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**CODE OF BEST PRACTICES - COMMODITY FINANCING**

**NOVEMBER 2020**

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## **INTRODUCTION**

Singapore is a global commodity trading hub with a thriving trading community. We regularly review our standards and practices to strengthen our resilience, relevance and competitiveness as a leading commodity trading hub.

An industry working group of 28 banks, which comprises the vast majority of commodity finance lenders in Singapore, was established in May 2020 to consider ways to strengthen and enhance the resilience of the commodity trading sector in Singapore. The working group is supported by the Monetary Authority of Singapore (“MAS”), Enterprise Singapore and the Accounting and Corporate Regulatory Authority.

Recognising that trade finance is important to support the sustainability and growth of the commodity trading sector in Singapore, the working group developed the Code of Best Practices - Commodity Financing (the “Code”), in consultation with commodity traders, to articulate key principles governing prudent commodity trade financing practices. Lenders should consider and incorporate these principles as part of their lending business practices in a risk proportionate manner.

Two key themes underpin the Code – (a) at a macro level, lenders’ understanding of the traders’ corporate governance, risk management practices, business and transactions through due diligence and policy requirements; and (b) at a transactional level, lenders obtaining sufficient transparency and control over the financed transactions, goods and receivables.

## **APPLICATION**

The Code is intended to apply to any financial institution (“Lender”), which is regulated by MAS, and is offering any loan, advance, credit or other financial accommodation to a Trader. A “Trader” is envisaged to be a person, or an entity, who buys, sells or trades in any produce, item, goods or article which is fully or substantially fungible with an efficient price discovery market and is identified by a Lender as a Trader based on that Lender’s internal policies. In the application of the Code to international Traders, Lenders may leverage or rely on the business due diligence and credit risk assessment conducted during the course of their global relationships although they are expected to maintain adequate information on the Traders locally.

The Code serves as a set of guidelines to provide broad guidance to Lenders, and is not meant to be exhaustive or to replace any legislation, regulations or guidelines issued by the relevant authorities in Singapore. MAS may refer to the Code in its supervisory oversight of the Lenders’ business and risk management activities. Further reference should always be made to applicable legislation, regulations or guidelines, which Lenders are required to comply with.

Lenders are expected to ensure that appropriate policies and procedures as well as controls are in place to observe the principles in the Code in a risk proportionate manner. The principles are supplemented with examples of good practices in the appendices. Lenders are encouraged to adopt them as applicable and appropriate, taking into consideration the risk, scale and complexity of the profile of a Trader and the financing activities undertaken. In this regard, the practices and examples listed in the appendices are not meant to be exhaustive, prescriptive nor to be used as a checklist.

## **GENERAL PRINCIPLES**

### **1. CORPORATE GOVERNANCE**

*Preamble: Good corporate governance facilitates appropriate management and conduct of the business and affairs of Traders and will better achieve accountability and transparency. Lenders should consider Traders' corporate governance policies and practices for credit risk assessments.*

- 1.1. Lenders should ascertain that each Trader has established corporate governance policies and practices that are appropriate based on its size, complexity and structure, and minimally address the following:
  - (a) segregation of roles and responsibilities within the board of directors or such other equivalent governance body, with defined and documented accountability and responsibilities of the various roles; and
  - (b) sufficient independence in the decision-making and exercising of judgements by the Trader's board of directors or such other equivalent governance body.
- 1.2. In assessing the appropriateness of the corporate governance policies and practices of a Trader, Lenders may refer to Appendix 1 which sets out examples of good corporate governance policies and practices.
- 1.3. Lenders should procure periodic updates from each Trader on its corporate governance policies and/or practices, including non-compliance, amendments, waivers or exceptional handling that could affect the effectiveness of the policies and/or practices.

### **2. RISK MANAGEMENT**

*Preamble: Risk management serves to ensure that appropriate policies and controls are adopted to effectively manage identified risks. Lenders should consider Traders' risk management policies and practices for credit risk assessments.*

- 2.1. Lenders should ascertain that each Trader has established risk management policies and practices commensurate with its business strategy, turnover, complexity of operations and risk appetite, and minimally address the following:
  - (a) segregation of roles and responsibilities among various functions, with defined and documented accountability and responsibilities of these functions;
  - (b) adoption of systems and/or processes to support timely identification and measurement of risks;
  - (c) regular monitoring of trading limits and risk position limits;
  - (d) controls to protect the integrity and security of information; and
  - (e) measures to mitigate price and trade risks.

- 2.2. In assessing the appropriateness of the risk management policies and practices of a Trader, Lenders may refer to Appendix 2 which sets out examples of good risk management policies and practices.
- 2.3. Lenders should procure periodic updates from each Trader on its risk management policies and practices, including non-compliance, amendments, waivers or exceptional handling that could affect the effectiveness of the policies and/or practices.

### 3. **BUSINESS DUE DILIGENCE**

*Preamble: Lenders should conduct regular business due diligence to obtain comprehensive information on Traders' operations, business and relevant aspects relating to commodity trade financing for credit risk assessment and mitigation purposes.*

- 3.1. Lenders should conduct proper and adequate business due diligence on each Trader regularly in order to assess and mitigate credit risk on a holistic and informed basis.
- 3.2. Lenders may refer to Appendix 3 which sets out examples of areas of information that they may request when conducting business due diligence for credit risk assessment and mitigation purposes.
- 3.3. Lenders should procure regular management reporting by each Trader at a frequency to be determined by Lenders on a risk-based approach.
- 3.4. Lenders should obtain independent verification of information provided by each Trader pursuant to this Principle 3, where determined by Lenders to be necessary on a risk-based approach.

### 4. **TRANSPARENCY AND CONTROL**

*Preamble: On a transactional level, Lenders should put in place measures to ensure that there is sufficient transparency and control in respect of the financed transactions, goods and receivables.*

- 4.1. Lenders should adopt and/or impose measures to ensure sufficient transparency and control over:
  - (a) transactions and the underlying goods that are subject to finance; and
  - (b) receivables associated with the sale of such underlying goods.
- 4.2. Lenders should procure that any letter of indemnity or undertaking (or any other similar documents) used in the absence of, or in lieu of, the original title and/or transport documents in respect of goods subject to finance shall, if required, be in such format acceptable to it, and issued in its favour and/or such party as it may require or agree to.
- 4.3. Lenders should procure that any assignment of receivables (whether by way of security or sale) in its favour is notified to the debtor of such receivables and use reasonable endeavours to procure that the fact of such assignment is recorded in all relevant invoices issued to such debtor.
- 4.4. Lenders may refer to Appendix 4 which sets out examples of measures that they may adopt and/or impose on a transactional basis.

## 5. **INDUSTRY COLLABORATION**

*Preamble: It is envisaged that there will be collaboration initiatives in the Singapore commodity finance sector from time to time which Lenders are expected to participate, where relevant, including initiatives to enhance risk identification and mitigation.*

- 5.1. Lenders should, where relevant, participate in industry collaboration initiatives that aim to further strengthen the commodity trading sector in Singapore. Future initiatives could include leveraging on technology to authenticate underlying trade transactions financed by Lenders and to enhance Lenders' assessment of the credit worthiness of corporate entities.

## Appendix 1

### **Examples of Good Corporate Governance Policies and Practices<sup>1</sup>**

#### *Board of Directors or such other equivalent governance body of Trader ("Board")*

1. Directors possess an adequate and appropriate level of understanding of the Trader's business and operations.
2. Responsibilities, obligations, expectations and delegation of authority of the various Board roles are properly formulated and documented and where necessary, charters and/or terms of reference are adopted.
3. The Board establishes criterion and processes to assess the effectiveness and performance of the Board, each Board-level committee and the individual directors at least annually.
4. The Board comprises of directors with risk management expertise and/or establishes a risk management committee to support the Board in risk governance. The risk management committee is responsible for setting, approving and monitoring the Trader's risk management policies, credit policies and internal controls.
5. The Board comprises an appropriate balance of executive and non-executive directors to ensure a strong level of independence in the Board. Non-executive directors form at least a majority of the Board to avoid undue or excessive influence by the management over the Board.
6. Non-executive directors are able to exercise independent judgement and do not have any direct or indirect relationship with the Trader (e.g. no kinship, cross-directorships, business, financial or other connections with the Trader), its related corporations, shareholders or officers. If the Board considers a director to be independent notwithstanding the aforementioned circumstances, the nature of the director's relationship is fully disclosed to its Lenders, together with the assessment of the independency of such director.
7. Non-executive directors (including independent directors, if any), led by the independent chairman of the Board or an independent director (as the case may be), hold meetings at least annually without the presence of the executive directors to assess, amongst other things, the performance of the executive directors and the effectiveness of the Board in performing its duties.
8. The chairman of the Board and chief executive officer roles are kept separate to avoid concentration of power and conflicts of interest. The chief executive officer does not exercise undue or excessive influence over the chairman of the Board that could potentially affect the exercise of independent judgment by the chairman of the Board.
9. An audit committee is established and is responsible for monitoring the integrity of the Trader's financial statements and reviewing its internal controls, the effectiveness of the Trader's internal audit function (if any) and the effectiveness, adequacy and independence of its external auditor.

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<sup>1</sup> *Lenders are encouraged to adopt the examples set out in this Appendix 1 as applicable and appropriate, taking into consideration the risk, scale and complexity of the profile of the Trader and the financing activities undertaken. In this regard, the examples listed in this Appendix 1 are not meant to be exhaustive, prescriptive nor to be used as a checklist.*

## *Policies*

10. There are clear conflicts of interest policies and procedures in place to identify and manage situations of actual, potential and/or perceived conflicts of interest.
11. A code of conduct is established to outline the Trader's values and principles, including expected levels of ethical behaviours. There are whistleblower policies and/or avenue(s) in place to enable incidents of non-compliance to be reported.
12. Assessment of performance and remuneration of directors and key management personnel are based on formulated metrics that support a sound risk culture and take into consideration the risk policies and align with risk outcomes. Employees are not encouraged to engage in excessive risk-taking for the purposes of achieving short-term results at the expense of long-term value creation.
13. Metrics to assess the performance and remuneration of non-executive directors take into consideration factors such as contribution, time spent and responsibilities and remuneration is not excessive to the extent that the independence of non-executive directors may be affected.
14. Claw-back provisions for executive and key management remuneration applicable under exceptional situations such as fraudulent conduct are imposed to improve accountability of executive directors and key management personnel.

## Appendix 2

### **Examples of Good Risk Management Policies and Practices<sup>2</sup>**

1. Clearly defined roles, responsibilities, risk appetite, risk measurements and reporting methodologies appropriate for the Trader's business strategy, turnover, complexity of operations and risk appetite.
2. Policies and procedures are established to mitigate risks, including hedging methodologies and practices appropriate for the Trader's complexity of operations and risk appetite.
3. Systems and processes are adopted to support timely identification and measurement of risks.
4. Duties and functions (e.g. traders, risk managers and back-office) are segregated to avoid conflicts of interest and reduce instances of undetected errors and/or opportunities for abuse.
5. Appropriate trading limits and risk position limits (e.g. stop-loss/open position/value-at-risk) are established, monitored and reviewed independently on a regular basis.
6. Performance indicators and compensation structure of traders are aligned to the defined risk appetite of the Trader.
7. Clear consequences for breaches of the risk management policy are articulated.
8. Robust IT support system is established to ensure the integrity, security and accessibility of all information related to the Trader's business operations.
9. Counterparties are evaluated rigorously, including setting of appropriate credit limits where applicable.
10. An independent risk controller, who is directly accountable to the Board and/or risk management committee (where established), is appointed to review (at least annually) and report on the appropriateness and effectiveness of the Trader's risk management and internal controls.

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<sup>2</sup> Lenders are encouraged to adopt the examples set out in this Appendix 2 as applicable and appropriate, taking into consideration the risk, scale and complexity of the profile of the Trader and the financing activities undertaken. In this regard, the examples listed in this Appendix 2 are not meant to be exhaustive, prescriptive nor to be used as a checklist.

### **Appendix 3**

#### **Examples of Information Relevant for Business Due Diligence<sup>3</sup>**

1. Financial statements (whether audited or unaudited).
2. Related party transactions (including but not limited to the use of assets and/or services of a related party to store, transport or deal with goods that are subject to finance).
3. Monies borrowed and any other financial accommodation obtained and the amount of liabilities owing thereunder (whether actual, prospective or contingent).
4. Turnover that have been sold or discounted and other transactions amounting to funding in respect of payables or receivables on a non-recourse or limited recourse basis (including but not limited to buy-back or repurchase arrangements).
5. Turnover (including but not limited to transactions relating to sale and/or purchase of goods which do not involve any physical transfer or movement of such goods).
6. Hedging policies and margin facilities, limits and/or other similar accommodation provided by the Trader's hedging counterparties and such other information as Lenders consider appropriate in order to understand and assess the hedging policies and practices.
7. Inventory on the Trader's balance sheet and ownership of such inventory.
8. Litigation, disputes and arbitration (whether existing or threatened).
9. Existing security interest over assets.
10. Set-off, deduction, counterclaim, withholding, pay-when-paid and other similar arrangements with the Trader's counterparties.

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<sup>3</sup> Lenders are encouraged to adopt the examples set out in this Appendix 3 as applicable and appropriate, taking into consideration the risk, scale and complexity of the profile of the Trader and the financing activities undertaken. In this regard, the examples listed in this Appendix 3 are not meant to be exhaustive, prescriptive nor to be used as a checklist.

## Appendix 4

### **Examples of Measures to enhance Transparency and Control<sup>4</sup>**

#### *Transactions subject to finance*

1. Trader warrants and agrees not to obtain any other financial accommodation and/or create any security interest in relation to the transaction and/or goods subject to finance without obtaining Lenders' prior written consent.
2. Trader declares that the transaction subject to finance is a trade transaction involving a genuine sale of goods in consideration of payment made or to be made for such goods.
3. Trader provides information on the end-to-end process and trade cycle in respect of the transaction subject to finance.
4. Trader is prohibited from entering into arrangements amounting to a set-off, deduction, withholding, counterclaim and/or pay-when-paid in respect of the transaction subject to finance and procures that all payments received in relation thereto shall be free of any set-off, deduction, counter-claim, withholding and not subject to any pay-when-paid or other similar arrangements.

#### *Goods subject to finance*

5. Lenders (and/or such other qualified inspection authority or agent) have the right to inspect and verify the goods subject to finance, where applicable.

#### *Title and/or transport documents*

6. Underlying title and/or transport documents in respect of goods subject to finance are consigned to, or endorsed to, the order of Lenders, or blank endorsed.
7. Any letter of indemnity or undertaking (or any other similar documents such as warranty of title or tank receipts) used in the absence of, or in lieu of, the original title and/or transport documents in respect of goods subject to finance: (a) is accompanied by a copy of the title and/or transport document referenced thereunder; (b) is redeemed on demand by Lenders within such prescribed period, failing which Lenders have the right to demand for immediate payment equivalent to the value of the transaction subject to finance from the relevant supplier; and/or (c) expressly incorporates the aforementioned right in sub-limb (b).

#### *Receivables*

8. In the event of assignment of receivables (whether by way of security or sale) in Lenders' favour:
  - (a) Lenders obtain acknowledgment of the notice of assignment from the relevant debtor (which may include an undertaking from such debtor not to amend any applicable instruments and

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<sup>4</sup> Lenders are encouraged to adopt the examples set out in this Appendix 4 as applicable and appropriate, taking into consideration the risk, scale and complexity of the profile of the Trader and the financing activities undertaken. In this regard, the examples listed in this Appendix 4 are not meant to be exhaustive, prescriptive nor to be used as a checklist.

- documents in any manner that may directly or indirectly affect payment rights and/or obligations);
- (b) Lenders have the unrestricted right to directly deal with the relevant debtor for verification of such receivables;
  - (c) where applicable, original invoices addressed to the relevant debtor are delivered by the Trader to Lenders, who will then forward such invoices to the relevant debtor;
  - (d) where applicable, payment undertaking is given by the relevant debtor in favour of Lenders (which may also include an undertaking from such debtor not to amend any applicable instruments and documents in any manner that may directly or indirectly affect payment rights and/or obligations); and/or
  - (e) where applicable, each document that the relevant debtor is party to or provided by the relevant debtor (including but not limited to applicable instruments and documents, acknowledgement of notice of assignment and payment undertaking) is signed by that relevant debtor and dated and, if required, accompanied by signature verification.

#### *Hedges*

9. In the event that the Trader hedges against price fluctuations of goods subject to finance, Lenders enter into contractual arrangements (e.g. tri-partite agreements) with that Trader and broker, where appropriate.