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Metal fraud's signal need for "virtual" documents

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Recent frauds involving base metal companies including UK-based RBG Resources have left major banks with egg on their faces and may signal the end for paper documents, hastening a move to electronic transactions.

A probe is under way in the United States where four men were arrested earlier in May on charges of swindling international banks out of as much as \$1 billion through bank loans.

The four are executives at New Jersey-based metal companies Allied Deals Inc., Hampton Lane Inc. and SAI Commodity Inc. The U.S. attorney's office and the FBI said the fraud had been going on since at least May 2000. It was conducted through London-based RBG Resources, which is now in liquidation and the subject of a Serious Fraud Office (SFO) probe.

"The thing that is scary about this, is that it has been going on for such a long time. It helps promote the argument for electronic documentation," a director at a major U.S. bank said.

The companies apparently used shell entities to pose as customers and suppliers, fabricating deals to secure fresh bank capital.

"These banks may not be big commodity lenders as such, but they run fully-collateralised lending policies, so if they get caught out by fraudulent documents there really is not much that can be done about it," the director said.

The money was not used to pay metals suppliers, but to fund accounts controlled by the traders or co-conspirators, according to allegations presented by the U.S. Attorney's Office for the Southern District of New York.

The crux of the scheme was the access to paper needed to print bills of lading - invoices used by shippers to prove ownership of different materials. The documents were so authentic that it was nearly impossible to detect fraud.

They then used these counterfeit assets to obtain loans from some of the world's largest banks, including FleetBoston Financial, PNC Financial Services Group and J.P. Morgan Chase.

But industry specialists said that this could have been averted by using bolero.net, an electronic trade community run by Bolero International Ltd since 1998. This has moved trade onto the internet, allowing documents and data to be exchanged online between all parties in the chain.

"It would be very difficult to carry out this type of fraud on bolero," Peter Scott, commercial director at Bolero, said.

"You cannot take possession of a document that is the result of fraud, nor can



There are around 120 members on the Bolero system, which range from major banks, trading houses such as Mitsui and Marubeni and electronic companies such as Samsung and Hitachi.

On the metals side BHP-Billiton and Rio Tinto are members, as is the Colombian Coffee Federation.

Scott said that Bolero has opened up a title registry for bills of lading, and that then covers the entire trail of the cargo. The system is secure, and a rigorous registration procedure acts as a gatekeeper for the community.

DOCUMENT FRAUD HAS HAPPENED BEFORE IN METALS

Industry specialists say that type of fraud currently being investigated has occurred before. In 1999 another metals company, Solo Industries, allegedly perpetrated a letter of credit (L/C) fraud against 21 banks.

"There are similarities to Solo, and the banks have been caught again - it is easy to say they should have known better," a senior trader at one of the London Metal Exchange's (LME) firms.

This case is believed to go back several years, with investigators looking back as far as 1996. It emerged that banks in the United Arab Emirates and elsewhere in the Gulf region, as well as in Europe, had made huge losses on letters of credit issued to Solo.

The trader said LME firms had been reasonably astute when dealing with RBG Resources and Allied Deals. RBG's activities aroused suspicion at its auditor, PriceWaterhouseCoopers, back in January, when it dropped RBG as a client after querying the validity of some of the trades listed on the company's books.

"We stopped trading with them about 18 months ago - the brokers that did trade asked for cash guarantees, they certainly didn't offer any credit lines," he said.

The LME itself has had an electronic safeguard since 1999. Known as SWORD, it produces and transfers title of LME warrants. Warrants are similar to bearer bonds and denote ownership of metal. SWORD has eliminated many of the manual processes involved in the transfer of warrants, which were both inefficient and subject to an element of risk.