War Series: Letters of Credit in the Crossfire – Sanctions Clauses, Frozen Reimbursements, and the Erosion of UCP 600 Autonomy

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Global trade runs on physical molecules and sovereign plumbing. When the custodians of the plumbing weaponize access, no amount of standardized paper can force a payment to clear.

For nearly a century, international commerce has operated on a disciplined legal fiction: the autonomy of the documentary credit. Under Articles 4 and 5 of the International Chamber of Commerce's Uniform Customs and Practice for Documentary Credits (UCP 600), banks deal exclusively in documents, never in the underlying goods, commercial disputes, or geopolitical grievances of the trading parties. Present a spotless bill of lading, a compliant commercial invoice, and a valid insurance certificate, and the confirming bank is irrevocably bound to pay. In theory, a confirmed letter of credit (LC) is the closest equivalent to cash in cross-border trade.

In practice, that bedrock guarantee is quietly disintegrating.

As the 2026 Middle East conflict disrupts physical shipping lanes and accelerates the weaponization of financial clearing networks, the autonomy principle is colliding with a far more potent force: the extraterritorial reach of sovereign sanctions and the retaliatory blocking statutes erected against them. Exporters are confronting a harsh operational

reality. A complying presentation under UCP 600 no longer guarantees settlement when the bank holding the reimbursement instructions fears regulatory exile in Washington, or faces statutory retaliation in Beijing.

The market is witnessing the structural erosion of neutral trade finance. What was once a mechanical, document-driven settlement engine has mutated into a contested geopolitical arena where banks price regulatory survival far above contractual certainty.

The Plumbing Beneath the Paper

To appreciate the magnitude of this fracture, one must examine the underlying mechanics of global trade settlement rather than the idealized prose of trade rules. According to the Asian Development Bank's Global Trade Finance Gap Survey, unmet global demand for trade finance stands at $2.5 trillion, roughly 10% of global merchandise trade. More revealing than the headline figure is its migration up the corporate food chain: rejection rates for mid-cap and large corporate borrowers surged from 30% in 2023 to 40% in the latest survey cycle.

This contraction is not a shortage of global capital; it is a crisis of financial plumbing. Roughly 80% to 85% of global trade finance transactions remain denominated in U.S. dollars. Every dollar-denominated LC, whether issued in Dubai to finance industrial inputs or confirmed in Singapore to settle petrochemical flows from the Arabian Gulf, must ultimately clear through correspondent accounts anchored in the United States. The architecture is inherently hierarchical. UCP 600 may be politically neutral, but the banks that animate it are anything but.

The ICC Global Banking Commission has fought a valiant rearguard action to preserve the integrity of its rules. In its Consolidated ICC Guidance on the Use of Sanctions Clauses

(revised in November 2024), the ICC cautioned financial institutions that sanctions clauses should not be inserted routinely, should refrain from unparticularized references to foreign laws, and should avoid referencing internal "bank policy and procedure" at all times. Similarly, in its April 20, 2026 guidance on the Middle East conflict, the ICC urged market participants to continue applying UCP 600, URDG 758, and URC 522 in the usual manner despite operational disruptions.

Industry guidance, however, carries neither statutory force nor the power to revoke a banking charter. When a compliance committee weighs a non-binding ICC recommendation against a U.S. Treasury enforcement action, the math is brutally straightforward.

The 2026 Gulf Stress Test: Kinetic Disruption Meets Dollar Chokepoints

Nowhere has this divergence between physical logistics and financial compliance been more acute than across the Gulf Cooperation Council (GCC) in 2026. Following the February 28, 2026 escalation of hostilities and severe disruption in the Strait of Hormuz, annual marine war-risk cover vanished into voyage-by-voyage pricing. According to a Howden Re market report, Gulf transit war-risk premiums jumped up to 12-fold in the opening weeks of the conflict, reaching 2% to 3% of insured vessel value, while Lloyd's List reported single-voyage war-risk cover topping $10 million for a very large crude carrier by July. After crude oil breached $100 per barrel in September, credit insurer Coface issued its October 13, 2026 Risk Review, downgrading country-risk ratings for Saudi Arabia (A3 to A4), the UAE (A2 to A3), and Qatar (A3 to A4) due to energy-infrastructure and Strait of Hormuz exposure.

For trade finance operations, the shock struck on two simultaneous fronts.

First, physical rerouting began generating documentary discrepancies at scale. As vessels diverted away from Gulf ports toward alternative Red Sea and east-coast gateways, legacy LCs naming a single port of discharge or imposing rigid 14-day presentation windows suddenly failed strict documentary compliance, handing risk-averse banks a clean contractual off-ramp to refuse payment.

Second, and far more consequential, Washington tightened the correspondent banking vise. On August 24, 2026, U.S. Treasury Secretary Scott Bessent launched "Operation Economic Outcast," expanding secondary sanctions risk under Executive Order 13902 across Iran's shipping, aviation, gold, technology, and digital-asset sectors, as reported by the Associated Press. The enforcement cadence that followed left zero ambiguity for regional lenders:

- On August 28, 2026, the U.S. Treasury moved to sever U.S. correspondent banking access for Banque Misr UAE, alleging the bank processed approximately $1.8 billion for 103 companies potentially tied to Iranian shadow banking networks.
- On September 4, 2026, Treasury designated Türkiye-based Golden Global Bank and two subsidiaries for providing correspondent banking access tied to Iranian oil revenue channels.
- On September 14, 2026, Treasury designated Russia's VTB Bank under E.O. 13902 for establishing correspondent accounts and national-currency settlement mechanisms with sanctioned Iranian banks.
- On October 5, 2026, the Office of Foreign Assets Control issued an explicit OFAC Alert to Foreign Financial Institutions, warning that non-U.S. banks facilitating Iranian financial channels or commodity-linked shadow banking face direct sanctions and potential civil or criminal enforcement.
- On November 23, 2026, Treasury escalated further,

sanctioning over two dozen additional Iranian exchange houses, front companies, and operatives after FinCEN identified nearly $15 billion in potential Iranian shadow banking activity between January 2025 and August 2026.

The second-order effect was immediate and entirely predictable. International confirming banks curtailed regional limits, repriced confirmation margins, and leaned heavily on sweeping sanctions exclusion clauses. When a regional trade flow touches a transshipment hub, an opaque vessel charterer, or a third-country intermediary, the correspondent bank's rational survival instinct is to freeze first and litigate later.

The Tripartite Fracture: London, Singapore, and Beijing

If global courts shared a unified doctrine on how sanctions interact with documentary credits, market participants could at least price the exposure. Instead, the three premier legal arenas governing cross-border trade, London, Singapore, and China, have fractured into irreconcilable camps.

London: Statutory Supremacy Over Contractual Autonomy

On March 25, 2026, the UK Supreme Court delivered a watershed decision in *UniCredit Bank GmbH, London Branch v Celestial Aviation Services Ltd* [2026] UKSC 10 that permanently altered the calculus for English-law credits. The dispute arose out of standby letters of credit originally issued by Russia's Sberbank and confirmed by UniCredit's London branch to secure aircraft leases for Russian airlines. When the UK amended Regulation 28(3)(c) of the Russia (Sanctions) (EU Exit) Regulations 2019 to classify aircraft as restricted goods, UniCredit withheld payment until securing regulatory licenses.

The lessors invoked the autonomy of the credit, contending that payment demands under the confirmations were legally distinct from the underlying leases. A unanimous Supreme Court

rejected that argument. Delivering the judgment of the Court, Lord Stephens confirmed that statutory sanctions cast a deliberately wide net: "in connection with" captures a broad factual link to a prohibited arrangement, suspending payment obligations even where the underlying leases and credits predated the sanctions.

More dramatically, the Supreme Court held that Section 44 of the Sanctions and Anti-Money Laundering Act 2018 (SAMLA) operates as a comprehensive civil-liability defense. Where a bank withholds payment in the *reasonable belief* that doing so is required to comply with UK sanctions, Section 44 shields the bank not only from statutory interest and legal costs, but from the underlying debt claim itself while the freeze persists. In London, statutory compliance now sits behind a reinforced bunker, leaving beneficiaries to absorb the financing cost of immobilized working capital while banks await ministerial licensing.

Singapore: Strict Scrutiny of Precautionary Compliance

Across the Indian Ocean, Singapore has drawn a far sharper line in defense of mercantile certainty. In *Kuvera Resources Pte Ltd v JPMorgan Chase Bank, N.A.* [2023] SGCA 28, a confirming bank refused to honor complying drafts after internal screening flagged circumstantial evidence suggesting the carrying vessel had a Syrian beneficial ownership nexus.

The Singapore Court of Appeal reversed the High Court and ruled squarely against the bank. Delivering the judgment, Justice Steven Chong emphasized that contractual interpretation, not geopolitical risk aversion, governs a sanctions clause embedded in an irrevocable confirmation. The Court rejected the bank's reliance on subjective risk-management assessments and inconclusive circumstantial indicators, holding that a confirming bank must discharge an objective evidentiary burden demonstrating that payment would *actually* violate applicable sanctions. Precautionary de-

risking, the exact reflex incentivized by Washington's enforcement posture, does not excuse non-performance under Singapore law.

Beijing: Turning Western Overcompliance into Civil Liability

If London shields precautionary freezes and Singapore constrains them, Beijing actively penalizes them. Following the State Council's March 2025 regulations implementing China's Anti-Foreign Sanctions Law (AFSL), Beijing expanded its legal counter-sanctions apparatus aggressively throughout 2026. On April 7, 2026, China promulgated State Council Order 835, establishing broad regulations to counter improper foreign extraterritorial jurisdiction. Less than a month later, on May 2, 2026, China's Ministry of Commerce invoked its 2021 Blocking Rules for the first time, issuing a formal prohibition order barring compliance with U.S. sanctions targeting five Chinese refineries accused of importing Iranian crude, as reported by Al Jazeera and Reuters.

The judicial enforcement mechanism followed swiftly. On June 24, 2026, China's Supreme People's Court released six representative maritime cases of 2025, highlighted by China Law & Practice as the first Chinese court judgment applying the AFSL to reject foreign sanctions compliance as a defense for contractual breach. In that Shanghai Maritime Court ruling, a carrier that halted performance out of fear of U.S. restrictions was ordered to pay full cargo damages plus interest notwithstanding foreign choice-of-law terms. For an international bank confirming an LC involving a Chinese supplier or consignee, invoking a broad U.S.-centric sanctions clause to suspend reimbursement no longer merely invites a commercial dispute; it invites mandatory domestic statutory liability against onshore assets.

The Asymmetric Mechanics of Frozen Reimbursements

Examine the resulting vise from the seat of a global trade-

finance bank operating across the Dubai–Singapore–Shanghai–London corridor. The incentives are hopelessly asymmetric:

1. **Pay against a shadow-sanctioned nexus:** Risk losing U.S. dollar correspondent clearing privileges under Operation Economic Outcast, an existential threat for any internationally active lender.
2. **Freeze payment on precautionary grounds:** Claim statutory immunity in London under *UniCredit* if UK sanctions are plausibly engaged, face a breach-of-confirmation judgment in Singapore under *Kuvera* if the evidence is merely circumstantial, and trigger statutory countermeasures and damages exposure in China under the AFSL and MOFCOM blocking orders.

Caught between these grinding tectonic plates is the exporter. A commodity trading house in Dubai or Singapore can load compliant physical cargo, present faultless UCP 600 documentation, and watch its reimbursement vanish into an indefinite compliance limbo, no formal dishonor, no statutory interest while a licensing application sits in a ministerial queue, and no assurance that dollar clearing through New York will resume. The autonomy of the letter of credit has not been formally repealed; it has been hollowed out from within by the sovereign plumbing required to settle it.

The Wartime Playbook for Trade Finance

Wishing for a return to unipolar financial neutrality is not a risk-management strategy. For commodity traders, corporate treasurers, and financial institutions operating across high-friction corridors, protecting working capital requires redesigning trade-finance documentation for a multipolar order:

- **Audit Sanctions Clauses Before the Vessel Sails:** Beneficiaries must stop treating confirming-bank

sanctions clauses as harmless boilerplate. Insist on objective, narrowly tailored wording tied strictly to *mandatory statutory illegality* in the place of payment, explicitly rejecting discretionary "internal bank policy" carve-outs in accordance with the ICC's revised Guidance.

- **Engineer Routing Resilience Into the Credit:** In active maritime conflict zones, single-port discharge terms and 14-day presentation windows are self-inflicted wounds. Structure credits with regional port ranges (permitting discharge across designated east-coast GCC or Red Sea gateways), explicit transshipment permissions, and extended presentation windows so wartime diversions do not gift counterparties a technical discrepancy defense.
- **Build Multi-Currency Fallback Mechanisms:** With 58% of surveyed banks reporting rising demand for local-currency trade finance, relying exclusively on single-correspondent USD clearing creates a fatal single point of failure. Embed pre-agreed fallback settlement rails (such as AED, EUR, or CNH) and alternative clearing banks in the underlying sales contract, triggered automatically if USD correspondent clearing is suspended without a primary sanctions violation.
- **Ring-Fence Licensing Delays and Financing Costs:** Following *UniCredit v Celestial*, beneficiaries cannot assume statutory interest will accrue while a confirming bank awaits regulatory licensing. Negotiate express covenants requiring the applicant (buyer) to bear carrying costs, demurrage, and direct alternative-payment obligations if LC reimbursement is suspended due to regulatory screening delays unrelated to the seller's own conduct.
- **Isolate Conflicting Statutory Perimeters in Advance:** Where trade flows intersect both Western dollar clearing and PRC counterparties, treat the selection of confirming bank, governing law, and dispute-resolution forum as primary commercial pricing terms. Ring-fencing

PRC-nexus facilities away from U.S.-dollar correspondent chains, rather than attempting to reconcile contradictory sovereign mandates inside a single LC, is increasingly the only durable hedge against bilateral legal exposure.

Takeaway

The documentary credit was engineered for an era in which sovereigns kept their geopolitical contests largely outside the clearinghouse. That era has closed. Between Washington's secondary-sanctions perimeter, London's statutory deference to sanctions freezes, Singapore's insistence on strict evidentiary proof, and Beijing's punitive enforcement of blocking statutes, the once-uniform language of UCP 600 now translates differently in every major financial hub.

Letters of credit remain indispensable to global commerce, but their promise of cash-like certainty can no longer be taken on faith. In a fragmented financial order, the party that controls the drafting of the sanctions clause, the flexibility of the shipping documents, and the redundancy of the settlement rail determines who gets paid, and who is left holding paper while liquidity remains frozen in transit.

Wasel & Wasel advises on complex commercial disputes, international arbitration, and cross-border financial litigation. The firm represents commodity traders, financial institutions, and multinational corporations in high-stakes proceedings before courts and arbitral tribunals across the GCC, DIFC, ADGM, London, Hong Kong, and Singapore. Our practice includes litigating documentary credit and demand guarantee disputes, navigating conflicting international sanctions regimes and blocking statutes, structuring resilient trade-finance documentation, and enforcing cross-border payment obligations amidst geopolitical disruption.

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