

# Avoiding fraud

Documentary fraud is the scourge of trade finance. P Mukundan, Director at the ICC Commercial Crime Services, comprising the ICC-International Maritime Bureau and ICC-Commercial Crime Bureau, shows how buyers, sellers and banks can be defrauded.

Fraud is not new. As long as there have been commercial systems in place for businessmen, there have been those who have tried to manipulate these systems. A large proportion of international trade is paid for under the documentary credit system.

Article 13 of the UCP 500 requires banks to apply reasonable care to ascertain whether documents, on their face, comply with the terms of the credit. In practice, this is the only way that the documentary credit system will work.

It would be unreasonable to expect banks, for the purposes of the documentary credit, to go beyond the documents presented. Banks take the view that they are merely financing the trade transaction. They do not assume responsibility for the existence or quality of the commodities traded. The system is based on documents. Documents can be forged.

## The buyer loses

This takes place under a letter of credit (LC). False documents are presented by the seller to the bank, which comply with the terms of the credit. The confirming bank pays out under these documents, debits the account of the issuing bank and sends the documents to the issuing bank. The buyer believes that the cargo has been loaded on board the ship and is on its way to its destination. In many cases it is only when the vessel is due to arrive at the destination port that the buyer discovers that the cargo, as contracted, has not been loaded on board. He has paid out under spurious documents. The fraudulent seller, having collected the purchase price under the LC, has long disappeared.

This is a simple format of the LC fraud. There can be many variations to this theme.

For example, the seller may ship inferior goods. The buyer may thus not be able to detect the fraud until the cargo has been discharged and cleared from the port.

Bills of lading may be pre-dated to take advantage of a higher price. For

example, the price of certain commodities, such as coffee and cocoa, may have a higher price for an August lifting as opposed to a September lifting. A September lifting may have the bill of lading pre-dated to August 31st to take advantage of the higher August price.

Sellers will sometimes introduce unknown third party suppliers into a fraudulent transaction. When the fraud is discovered by the buyers, the seller claims he is himself a victim of the fraud of the third party supplier. The third party supplier, if he exists at all, will usually be located in a country where identification and recovery is difficult.

The fraudulent seller may ask the buyers to issue a transferable LC. The fraudster would then transfer the LC to a company controlled by them in a place of convenience. When the fraud is discovered, the transferee of the credit is blamed. The seller claims that the fraud had been committed by the transferee and he, himself, was a victim. Investigations may not be able to identify the principals behind the transferee company.

It is, therefore, important that if a transferable LC is opened, then the buyers make checks into the track-record of the transferee, as carefully as they would in the case of their direct contractual partner. It may not always be possible in the real world of trading to get information regarding the identity and background of the transferee. But if the buyer is in the stronger negotiating position he may be able to insist that the seller advise him of the identity and background of the transferee.

Of necessity, the LC transaction and most other documentary credits depend heavily on documents being correct, on their face. However, what is not always appreciated is that most of these documents have very little security features to prevent their forgery.

The bill of lading is the document, which can confer title to millions of dollars-worth of cargo. Yet it is a rela-

tively simple document, which should pose no great difficulty to a fraudster to reproduce. There is often little physical control exercised by some liner companies over their blank books of bills of lading. These blank documents are often given away to freight forwarders and other sub-contractors to fill up and return to them for stamp and signature.

A fraudulent seller does not need to go back to the liner company for stamp and signature. It is possible for him to forge the stamp and signature to satisfy the examination by the staff of most documentary credit departments of banks.

The banks have no way of verifying the stamp or signature of a bill of lading. This also applies to other documents required under an average LC.

Like most commercial systems, the LC system is designed for use by the honest businessman. It is not designed to protect him from the fraudster. The buyers must therefore make checks into the track-record of the sellers before they open a LC. In today's world of sophisticated printers and colour copiers, a fully operable LC in the hands of a fraudulent seller is not dissimilar to a blank cheque.

## The seller loses

This happens usually under the documents against payment arrangement (d/p). In this case, a seller would ship the cargo, collect the bill of lading and other relevant documents and send it through his bank to a collecting bank in the country of the buyer.

The seller depends upon the fact that the buyer will not be able to collect the cargo from the ship-owners unless he produces the original bill of lading. In order to get it, the buyer would have to go to the bank, pay for the cargo, take the bill of lading, present it to the shipping agent at the discharge port and collect his delivery order. With the delivery order he would go to the port and collect his cargo. That is how the system is supposed to work.

In practice, the seller, having sent his documents to the collecting bank will send to the buyer a 'non-negotiable' copy of the bill of lading. He does this to advise the buyers that the cargo has been shipped, giving details of the ship, the bill of lading number, the container numbers, description of the cargo, and so on.

The non-negotiable copy is the exact replica of the original bill of lading, except for the fact that across the face it reads, 'non-negotiable' instead of 'original'. The seller knows this, so do the fraudulent buyers. Based on the non-negotiable copy of the bill of lading, the buyer prepares an original.

In these days of computer-generated documents, print sizes and fonts are all standard and there are no unique characteristics to the print appearing on an original document. This is particularly the case with ink-jet and laser printers. So the buyer should have little difficulty in preparing a bill of lading, in which the appearance of the script is exactly the same as the original.

With the help of a few false stamps, this document would pass internal examination at the shipping agent's office.

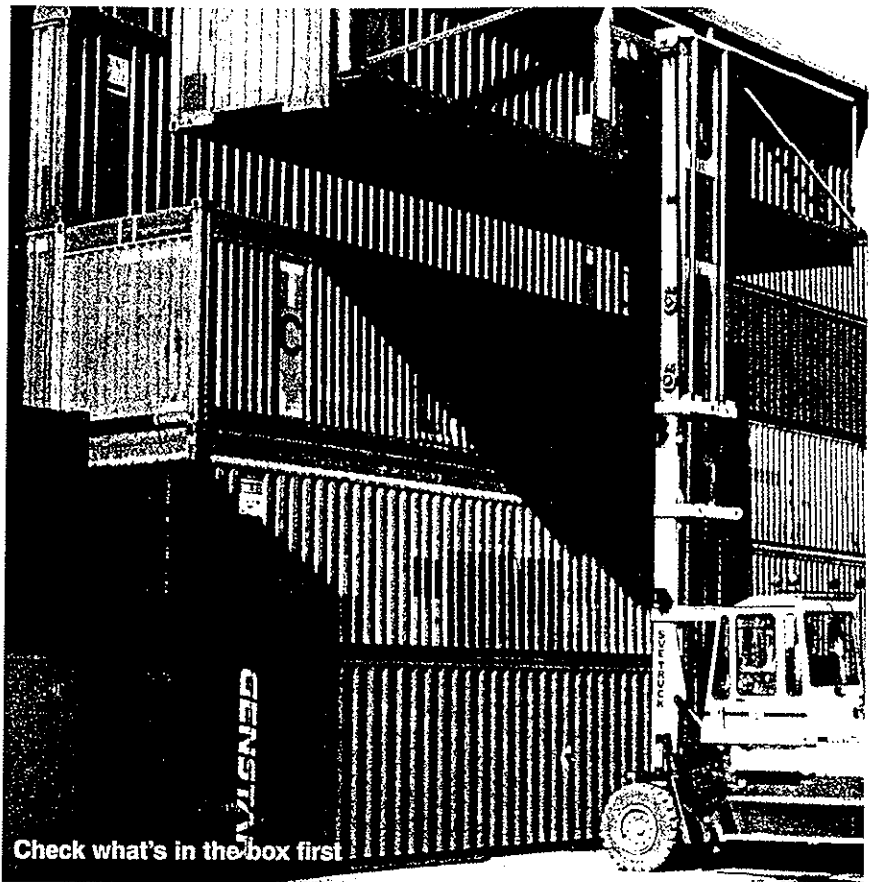
A delivery order is collected against the presentation of this false bill of lading and the cargo is removed from the port by the buyers. After many weeks, the hapless seller makes enquiries to ascertain what has happened to the documents they had sent for collection. They are told that the documents are still lying with the bank. No one has come to collect them. The sellers have thus been defrauded.

In this case, the sellers holding the original bills of lading may have a claim against the vessel for wrongful delivery of the cargo.

### Recovery of losses

When a buyer or a seller loses millions of dollars-worth of cargo they do not usually accept their losses quietly. They try to find some way to recover them. The common targets of their efforts are the deep pockets in international trade, ie, the banks, the insurance companies, and the ship owners.

In a LC transaction, a victim buyer will often re-examine the documents in great detail to find discrepancies the confirming bank may have missed. The idea being to hold the confirming bank responsible for the fraud of the sellers. The buyers can only do this however, before the issuing bank accepts the documents with-



in the seven banking day period allowed for under Article 13 (b) of the UCP 500.

The buyers choose to ignore the fact that the loss is a consequence of the buyer having chosen, in the first place, to transact with a fraudulent seller.

Going by the recent decision of the English courts in the case of *Banco Santander v. Bayfern Limited and Others*, the buyers may, in some circumstances, be able to reject the documents under a usance LC, if the fraud is discovered before the deferred date of payment under the LC. It increases the risk of the confirming bank discounting a usance LC. This decision is under appeal (see page 14).

If a buyer or seller cannot build a case against the bank, they might try to go for the other deep pocket in international trade, the insurance company. If the cargo never existed in the first place the insurance policy will not come into effect. The loss would, therefore, be borne by the buyers themselves.

The last deep pocket is the ship owners. If they have delivered the cargo under a forged bill of lading (the original not having been retired), they would be liable to the bill of lading holder, unless they can prove collusion between the buyers and the sellers.

In our view it is always best for the victim to go against the perpetrators of the fraud itself. For this to happen the victim must act quickly and positively before the fraudsters collect the money from the confirming bank. Once the money has disappeared the chances of recovery are small and the options are all expensive.

We recommend that buyers of cargo ask for copies of the documents presented under the LCs to be couriered or faxed to them before presentation to the banks. This will allow them time to make independent checks to confirm whether the bill of lading is genuine. If it is not, they will be able, in most cases, to go to the courts in the country of negotiation of the LCs and try to injunct the proceeds, before the money is remitted out. Once the funds have been paid to the sellers, there may be innocent parties who may lose out as a result of the injunction, such as for example, the negotiating or confirming bank.

In these cases, most courts may be hesitant to issue an order, the result of which may not preserve the proceeds of the LC, but harm the bank who may have had in all innocence paid out.

### The bank loses

In most cases of documentary fraud, the banks, in one way or another lose.

At the very least, the fraud will strain relations between the bank and its customers or the correspondent banks in the LC transaction. The greatest danger though, to banks, is when they are financing a transaction where the buyers and sellers are in collusion.

The bureaux comprising the ICC-Commercial Crime Services – the ICC-International Maritime Bureau and the ICC-Commercial Crime Bureau – have investigated numerous cases where banks have financed transactions, which they believed to be genuine arms-length trade deals between the buyers and sellers. No effort was made to check whether the documents presented were genuine.

As the volume of the transactions increased, the banks extended even better facilities to the buyers/sellers. The contribution of these traders to the fees earned by the documentary credit department of the bank became significant. There was a hesitance by the bank staff to examine the transactions with, perhaps, the care and detachment that might be prudent in the light of the sums advanced.

The bureaux investigated a case where a bank had financed a chemical supplier from the UK for his trade to buyers in Nigeria. A policy decision was taken by the bank not to continue to provide credit facilities for the trade to Nigeria.

What the trader did was to present documents to the bank to show that he was now exporting the cargoes to Switzerland, against which the bank was happy to provide even better facilities than they had for the trade to Nigeria.

What the bank did not know was that the chemicals were still being exported to Nigeria, but false documents were presented to show that they were going to Switzerland. The chemicals would arrive in Nigeria, be sold in the local market and the proceeds would then find their way back into Switzerland, in time to meet the deferred payment arrangements, which the trader had with the purported buyers there.

This ruse worked successfully for many years, until the bank holding the funds in Nigeria ceased operations. The money flow to Switzerland stopped and it was not possible to make the payments from Switzerland to the bank in London. It was then that the London bank began making investigations through the IMB and found that for a good many years they had

been financing a trade which had not existed.

There is currently another major international fraud under investigation, where a trading group with offices in many countries, has similarly defrauded a number of banks.

The documentary credit system can be used as a cover for many activities, which the banks are led to believe are trade-based.

It is accepted that the banks have no duty to look beyond the face of the documents under the UCP 500. This is the only practical way for the documentary credit system to work. The level of fees charged by the banks for this service do not justify the banks taking any further responsibility. It is vital that the system continues to function, for after all, the vast majority of trade transactions are conducted between honest buyers and sellers.

Notwithstanding this, it is our view that it is in the banks' own interest to ensure that they know precisely what activities their clients are asking them to finance. The way to do this is for them to make independent checks into the transactions, i.e. to authenticate the bills of lading and other documents presented under the documentary credit system. It is only through these independent checks that the banks can be sure that they are financing what their clients are declaring to them. This is not a question of their liabilities under the UCP. In our view, it is just prudent practice.

We recommend that banks pick up bills of lading presented to them, at random, among their good and not so well known clients and have them checked at regular intervals. Such checks are done free by the CCS Bureaux for banking members.

If they fail to do this, they may find, as banks involved in these frauds have discovered, that their exposure to some of these fraudulent companies have grown so much that it may have a significant bearing on the performance of the branch of the bank handling the transactions.

An important piece of collateral within the transaction may be the bill of lading consigned to the bank. The bank feels that, if all else fails, with that bill of lading they will be able to get their hands on the cargo and thus recover some of their losses. But, if that document itself is false, they have no collateral. They may be financing a transaction worth millions of dollars based on a non-existent cargo.

When these companies go down it will be the bank that loses. Hence, the need by the bank to check, for its own internal purposes, whether or not documents presented are genuine. There is also the risk that the bank may have unwittingly become involved in money laundering.

### Avoid it

The risk of documentary credit fraud can be minimised if buyers and sellers check into the background of their contractual partners before entering into commitments.

The documentary credit system can be used as a cover for many activities other than those declared to the bank. This can place the bank at great risk, not only from regulatory authorities, in respect of money laundering, but also directly as a result of the failure of their customers to pay back the debts to the bank.

Any document can be forged. Under the UCP 500, the banks are only required to examine the documents on their face. Quite apart from this obligation, for purposes of due diligence, it may be important that banks make independent checks into the background of some of the documents presented to them under the documentary credit system.

Some major frauds recently have revealed that if banks fail to do so they may find themselves facing substantial losses.

When large losses occur the victims will often go for the deep pockets in international trade. The banks and insurance companies must, therefore, be aware of where the vulnerabilities in the system lie. When a fraud has occurred they must be aware how they can be best investigated and losses recovered.

For a recovery action in a LC fraud to be successful, it is important that the victims take prompt and positive action to investigate and injunct the proceeds of the documentary credit. Once the funds have disappeared the chances of recovery may be minimum and the options of investigation and litigation very expensive.

The Bureaux of the ICC-Commercial Crime Services, particularly the ICC-International Maritime Bureau and the ICC-Commercial Crime Bureau, provide due diligence services to banks and traders, to prevent them falling victim to this kind of fraud. Many of these services are free of cost to members and is a cost effective risk management service. ■