PROTECTION AGAINST LETTERS OF CREDIT FRAUD

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ABSTRACT

Letters of Credit (Ls/C), the most common form of financing international commerce, have been a major source of worry for the whole international business world in recent years due to Ls/C fraud. Every year, the parties to the LS/C transaction lose billions of dollars due to fraud. A variety of reasons have led to the proliferation of such frauds. Many of them include the exclusive use of paper in international commerce, geographical distance in international trade, containerization, the usage of discounted Ls/C, and the absence of prosecution. Many academics and legal experts have been hesitant to interfere in Letter of Credit (Ls/C) transactions and have criticized local government regulations all around the globe. Allowing the courts to intervene with bankers' guarantees, according to government officials, may risk its integrity and make it more costly and ineffective than required. Due to a lack of regulation, recent research indicates that relevant organizations take certain measures to prevent Ls/C fraud, such as verifying the seller's reputation via well-known transportation services. Shipping, pre-shipment inspections, performance bonds, and electronic trade papers are all part of the process.

Keywords: International Trade, Sales Agreement, Documentary Credit, International Chamber Of Commerce, Documentary Credit Fraud

INTRODUCTION

Payment *via* L/C is very frequent in international commerce. RD Necklace Bottle (Mercantile) Ltd. & Others *vs*. National Westminster Bank Ltd. & Others, 1977; RD Necklace Bottle (Mercantile) Ltd. & Others *vs*. National Westminster Bank Ltd. & Others, 1977; and many other payment-related cases. This is the most effective method of obtaining payment in international commercial transactions since it safeguards both the seller and the buyer's interests. A Letter of Credit (L/C) has been created to ensure that the seller is paid by a bank located in his jurisdiction. The buyer arranges the L/C in such a manner that payment is assured upon presentation of specified papers confirming that the goods provided to the buyer are the products described in the sales contract's fundamental conditions. Are based on only the seller must adhere to the credit's paperwork criteria, and payment will be assured. The International Chamber of Commerce (ICC) has updated its sixth edition to include Uniform Customs and Practice for Documentary Credit, 2007 (UCP 600).

Uniform Customs and Practice (UCP) was published for the first time in 1933. The UCP is a collection of rules and norms, not a piece of legislation that governs L/C transactions. The UCP was established to guarantee that merchants and banks' rights under L/C transactions are governed by a uniform set of rules and norms rather than by local laws. UCP is widely recognised and enforced as a set of standards regulating L/C transactions. On the other hand, the UCP remains quiet on the subject of fraud. Fraud in LS/C transactions is controlled by local laws or case law in each nation.

LITERATURE REVIEW

Given increasing concerns regarding document loan fraud, the role of municipal law in combating fraud has been brought into question in several nations across the globe. The United States and the United Kingdom, in particular, whose standards of conduct are often employed as decision-makers in other countries, have been heavily criticized. These nations are known for not interfering with document lending operations (Farar, 1997). Many writers have chastised the English courts for their lack of involvement in document lending deals. Scammers are reportedly able to take advantage of the L/C system through this form of the lawsuit (e.g., Barnes & Bourne, 1995 Bar Barnes, 2001; King, 2001; Eden, 2001; Demir Araz, 2002). For example, in the case of a fraud accusation, English courts are hesitant to grant a temporary restraining order to prohibit a loan extension. The fraudsters claim to have escaped with money in their possession, removing themselves from the jurisdiction of the nations and parties involved.

English courts have claimed in their defence that if the courts interfered in the documented loan transaction, fraud would be minimised to some degree. Nonetheless, trust in international trade will suffer. As a consequence, recorded credit will no longer be accepted as a payment guarantee in international commerce (Zaronank-Ryanda *vs*. Sugar Trading Inc. *vs*. Standard Bank London, 1999).

Furthermore, many writers have suggested a range of fraud-reduction methods (such as Pig Thomas, 1999; Demer Aries, 2002; Ho, 1997). None of them, however, have addressed the direct and indirect expenses, as well as the problems that may emerge if such techniques are employed to avoid fraud. He claims that no one has listened to numerous courts' warnings that tampering with documented loan transactions might endanger the whole process of funding international commerce *via* LS/C. Is a question?

For instance, the Pakistani government issued an order in early 2006 requiring food imports, particularly rice, to be tested for quality in Pakistan and no credence will be given till the Pakistani laboratory provides an acceptable report.

Before the credit was negotiated and granted, banks were compelled to add a condition in the documentary credit demanding a post-landing inspection certificate from the country of purchasers verifying the quality of the imported products. by the way... Vendors, on the other hand, disliked the concept and were hesitant to sell their wares in such a hostile environment. In these conditions, some merchants were ready to sell to Pakistani customers, but they wanted higher rates. The government was compelled to soften the directive in early 2007 (The Nation, 14 January 2006).

As a consequence, things are precarious. On the one hand, enacting tighter criteria for honoring Ls/C to minimize the danger of fraud may erode the trust of those who are interested in the mechanism. Enforcing its laces fair approach, on the other hand, may lead to fraud. This situation necessitates the creation of methods for reducing the risk of fraud while maintaining the integrity of recorded loan transactions. Based on secondary data, literature, articles, debates, and examples, this article analyses the reasons for the development of L/C fraud and explains some of the methods in which fraud may be minimized.

LETTERS OF CREDIT

A letter of credit is the most frequent form of payment for international commerce. Methods of payment in which a bank (issuing bank-IB) pays a third party (seller or beneficiary) at the request and direction of its customer (buyer, L/C applicant) (Dolan, 2001). "Letters of credit are provided by banks to fulfil clients' financial responsibilities," he said, "to offer it another option", 1995).

Documentary Filmmaking Credit (s) and standby letter of credit (hereinafter referred to as 'credit ())' means any arrangement, regardless of the name or statement of which a bank (issuing) Wala) acts on the request and at the direction of a customer (applicant) or on his behalf I pay the order of a third party ('beneficiary') or on his behalf, I accept and pay the order of a third party ('beneficiary').

AUTONOMY OF LETTERS OF CREDIT

A documented credential is a distinct transaction unconnected to any fundamental agreement (UCP). As a consequence, banks are not concerned about whether the recipient has met his contractual duties. Banks cannot withhold payment even if the fundamental agreement is breached owing to faulty or late delivery of goods. Banks must pay as long as the papers provided show that the L/C criteria have been fulfilled. This is because all parties engaged in the documentary loan transaction only trade on paper, not in goods or services (UCPs). If the sales agreement is broken, the buyer may sue the seller, but the L/C payment obligation cannot be ignored since the original sales agreement was broken. British IMAX Industries Ltd. *vs*. Hamzia Malas & Sons Two Ls/C was established in 1958 to facilitate the purchasing of steel bars. The first L/C was paid, but the buyer sought a restraining order to prevent payment of the second L/C because the goods were faulty. The Supreme Court decided that since the papers provided were in order, payment could not be withheld because the goods were faulty. Buyers often take these goods to court, alleging that they violate the terms of the agreement and seeking a restraining order to prevent the beneficiary from making payments to the issuing bank. However, the courts are hesitant to grant such injunctions (Kerr, 1999).

This is because the courts do not wish to examine the fundamental contract of sale while determining whether to stop LS/C payments. This is because L/C is a distinct transaction that enables purchasers to interfere with the bank's payment responsibilities due to a mistake in the selling agreement, significantly affecting international commerce. The seller's payment assurance, which enters into a contract of sale and believes it will be repaid on a non-refundable credit, maybe shattered (Discount Records Ltd. *vs*. Barclays Bank LTD, 1975).

The Exception of Fraud

Ls/C sovereignty has just one exception, and that exception is fraud. Cheating this rule does have one exception. "Where the seller seems to be behaving dishonestly to get credit."

Appropriate bank documents including clear or tacit information showing his ignorance. (United City Merchants) (Investment) Ltd. and others *vs*. Royal Bank of Canada, Vitroverfeuros SA, and Banco Continental S.A, 1982). To assess cases of fraud, evidence of fraud is required. United Trading Corporation S.A *vs*. Allied Arab Bank Ltd., 1985) and Murray Clayton LTD *vs*. Allied Arab Bank Ltd., 1985).

Beneficiary If the recipient did not commit fraud but a third party did and he was ignorant, the banks must compensate. In United City Merchants (Investment) Ltd. and others v. Royal Bank of Canada, Vitroverferos SA, & Banco Continental SA, 1983, this was fabricated by loading brokers acting as agents. Beneficiaries' desire to comply with documents becomes uncontrollable. The court dismissed it. Arguing and saying that there is no horrible defense to recorded fraud since there is no evidence that the receiver did it, credit and banks must pay. Fraud, or whatever he was aware of.

Documentary Credit Fraud - Common Grounds

Documentary fraud is a complicated area with a wide variety of possible outcomes. A typical fraud technique is to target goods in great demand and supply them at absurdly low prices through convincing papers. The fraudster is often the vendor in a recorded credit transaction, although it may also be the buyer or a combination of the two. When it comes to L/C transactions, fraudsters have developed a variety of deceptive techniques. The following are some of the swindling techniques that have been discovered so far.

Buyers Defrauded

The buyer and seller have an agreement in which L/C enables the seller to deposit the items on L/C following delivery. The vendor then supplies the issuing bank with plausible shipping papers, but nothing is delivered. The credit bureau documentation is correct, and the negotiating bank pays the sellers. Due to the transition time between the forged port and the departure port, it may take weeks for a buyer to realize that no items have been delivered and that the papers processed through the banking system are fake. Meanwhile, the seller avoided punishment (Goodyear, 2001).

The vendor sometimes moves small amounts of high-quality goods, and on occasion, the whole garbage, filling the containers with sand, gravel, or rubble. The seller's items are anticipated to be invoiced on a "must contain" basis. The shopkeeper receives the money from the L/C issuing bank, and the ship vanishes before reaching its destination. Occasionally, a cargo is completed by sending nothing. The vendor is paid in L/C by creating a full set of fake documents, including the leading bill, as needed. When goods or a ship is not accessible, fake documents are occasionally used to collect money. When the buyer seeks reimbursement from the insurance, the insurer refuses to pay, saying that the customer is unprotected since the covered goods do not exist. This is by far the most misleading technique ever used by an artist (Lou, 1999).

Issuing Banks Defrauded

At the document trade, the sellers take the items and deposit the original papers in the issuing bank, which is typically located in the buyer's country. Meanwhile, they charge "non-negotiable" invoices to purchasers to inform them of shipment. When the ship arrives at the ship's departure port, when the shipping agent's delivery order comes, the buyer creates a false 'original' bill of lading based on the non-negotiable bill of lading and presents it to the shipping agency. It is used to clean cargo. Outside the port, the buyer abandons the goods, leaving the bank obligated to pay the vendor (Damir Ariz, 2002).

Confirming Banks Defrauded

Delays at suitable banks may result in the granting of Ls/C or credit waivers later rather than at the time of purchase. Instead of shipping products or garbage, the vendor generates falsified invoices. Occasionally, vessels and equipment are fabricated, and false documents are used to defraud the bank (Lloyds List, 1999). To conceal the facts, the unethical vendor leaves before getting a credit waiver from a synchronised bank. When the credit runs out, the synced bank contacts the original bank to request payment, but the scam has already been detected (Banco Santander SA *vs.* Bayern Ltd. et al., 1999).

Insurance Companies Defrauded

Parties may engage in sales contracts, ship no products or garbage, but issue fake bills of lading, wreck the ship en route, and then sue the insurance company for payment of the sales contract price and damages. Occasionally, a ship is loaded with legal cargo, but the cargo is sold to a third party, who subsequently destroys the ship and sues its insurance (Demir-Araz, 2002).

Documentary Credit Fraud Incidences

As previously mentioned, document loan forgery is growing like a disease across international commerce. Each year, verified loans cost millions of pounds, according to a 1995 ICC study (ICC, 1995). According to a 1999 report, banks lost millions of pounds, with Citibank losing thirty million, ABN Amro losing sixteen million, and Barclays losing thirteen million (Lloyds list, 15 November 1999). For instance, the United Arab Emirates Central Bank once suffered a loss of US $6,650 million (Damir Ariz, 2002). RS was defeated. In a similar occurrence that year, the State Bank of India's Kolkata branch lost Rs 1,000 million in credit against fraud. /Ls (Hindu Business Line, January 30, 2002) On September 19, 2003, a man was sentenced to two years in jail at the Old Bailey in London for his involvement in the L/C fraud involving multinational banks. Around $200 million was invested (Financial Times, September 20, 2003). In India, on December 31, 2006, a special court of the Central Bureau of Investigation (CBI) convicted a man to five years in jail for defrauding the Assam Veterinary Department of 4,000 million L CRS. (Sunday, December 31, 2006, Hindu).

Common Reasons for the Rise in Credit Fraud in Documentaries

Use of Documents Exclusively

A documentary credit transaction involves the exchange of documents. Banks are mainly interested in documents that will enable them to meet their letter of credit commitments. Because the papers represent money, an unscrupulous receiver may easily forge and counterfeit them. For instance, a beneficiary might submit lower-quality goods but alter the bills of lading and quality certificates to meet the contractual requirements, then claim money using these forged documents.

Two events in legal history may serve as better examples of the aforementioned scenario. One such example is the selling of 3,000 tons of coffee to the Cuban government. The con artist used an old ship bound for Cuba that was devoid of coffee. The payment was obtained *via* the forgery of a bill of lading. The ship was to be destroyed on the route, but something went wrong, exposing the hoax. Angola Another example is groundnuts: Angola purchased groundnuts but never received them; instead, a forged bill of lading was created and payment was obtained from the bank (Demir-Araz, 2002). Because documents are valuable in a documented credit transaction, fraudsters are capitalizing on the chance to deceive foreign merchants.

Geographic Distinction

Documentary credit was created as a result of the geographical distance involved in marine commerce. This is one of the main reasons for the development of documentary credit. This gives the fraudster plenty of time to collect money before the products arrive at their destination when the scam would be discovered. Despite rapid communication and automated accounting, Bennett (1992) argues, shipping is nevertheless plagued with paperwork. Because, unlike aero planes, ships arrive at their destinations in weeks rather than hours, rather than hours or days. This means that criminals are given more time to hide their traces and avoid detection.

Containerisation

It's challenging to determine the quantity and quality of goods delivered in the containerized warehouse to warehouse shipments. Shipping companies are only responsible for delivering cargo to designated destinations; they are not responsible for inspecting the products. Bills of lading are issued based on the presumption that they "are intended to include." As previously mentioned, an unscrupulous seller may deliver worthless or inferior items, forge documents stating the goods are contract-type merchandise and collect money.

The Fraud Exception is too Limited

In almost all countries, fraud exceptions are regarded as very restricted (Oelofse, 1997). courts have been reluctant to interfere in documentary credit transactions because of concern for the sovereignty of lenders (Pugh-Thomas, 1996). Proof of fraud requires a very high level of proof. An allegation of fraud or suspicion of fraud (Discount Records Ltd *vs*. Barclays Bank LTD, 1975) is insufficient to prohibit the payment of a documented credit, according to the Federal Trade Commission. So that the bank may stop paying the recipient, there must be fraud in the documents supplied, and payment cannot be stopped because of defective or late goods. Un fraudster must be recognized before he or she can get paid on a credit (United Trading Corporation SA and Murray Clayton LTD *vs.* Allied Arab Bank Ltd, 1985).

An unknowing beneficiary cannot conduct fraud, and a third-party fraud that the beneficiary was ignorant of is not enough to prohibit a credit from being granted. There is no way for banks to stop payments or for courts to issue a restraining order where the fraud was not perpetrated by the recipient or was not known to him. A similar ruling was made by the House of Lords of England in 1983 in United City Merchants (Investments) Ltd & Glass Fibres &

Equipment Ltd v Royal Bank of Canada, Vitrorefueros SA & Banco Continental SA. Due to the above-mentioned strict requirements for establishing fraud, the fraud exemption is extremely limited. It's rare that a buyer proves fraud and obtains a court order preventing a fraudulent receiver from utilizing the credit. It doesn't matter if a bank knows that the receiver is a fraudster, it still has to pay since it cannot prove it. Weakened by a court's refusal to interfere with bank guarantees, fraudsters may take advantage of the system (Demir-Araz, 2002).

Prosecution Abandonment

Although documentary credit fraud causes billions of dollars in damages every year, there is yet to be a global agreement to help in the prosecution of those responsible for it. Fraudsters may live in relative safety in tropical countries after committing their crime because, even if the buyer or the bank finds them, they will not be prosecuted for a crime committed thousands of miles away from home (Demir-Araz, 2002).

Several Suggestions to Reduce the Risk of Documentary Credit Fraud

Likely, documented credit transaction fraud may never be eliminated. "Like other commercial systems, the L/C system is designed for use by the honest businessman," explains Mr P.K. Mukundan, Director of the International Maritime Bureau and the Commercial Crime Bureau of the International Chamber of Commerce. It isn't meant to protect him against the con artist." While no recorded credit transaction will ever be completely secure, certain measures may be done to minimize fraud. These are dealt with farther down.

Checking the Seller's Background

Buyers and sellers may help mitigate the risk of documentary credit fraud by conducting background checks on prospective contractual partners before entering into agreements. Unscrupulous international commerce partners often try to offer an unusually low price for goods.

Numerous credit rating agencies are constantly researching the histories of suppliers worldwide. Although such a service is not free, it may ultimately save the parties concerned a great deal of money. While vendors with good credit may charge a bit more, buying from trustworthy merchants decreases the likelihood of getting cheated.

Reliable Transport Services for Goods

Product shipment through well-established and reliable transport service providers may aid in the prevention of fraud. By doing so, the buyer may conduct some basic safety checks, such as establishing whether or not the vessel assigned to make the trip can transport the particular cargo and whether or not it will call at the designated loading port and is scheduled to proceed to the discharge port. Many shipping companies use cutting-edge information technology to track vessels and containers online for registered customers. Interested parties in the transaction may verify information from the conforming documents with the shipping companies while the payment is being negotiated.

Pre-shipment Inspectors are used Extensively across the Organisation

As with other business transactions, documentary credit transactions are hazardous. The buyer carries the risk in the majority of L/C transactions since he must pay the seller based on documents. To guard against fraud, the buyer may insist on independent inspectors verifying the quality and quantity of goods. While employing pre-shipment inspectors increases trade expenses, it has the potential to substantially decrease fraud (Ho, 1997). Additionally, purchasers may send a surveyor to the loading port to examine the merchandise and supervise the loading procedure. Arranging for a cargo surveyor to remain onboard the vessel throughout the voyage, if possible.

Numerous nations now use pre-shipment inspection services to check products before they arrive in the exporting country. Pakistan, for example, mandated pre-shipment inspection in 1999 (PSI Rules (as amended after 1999)) and 2002 (Pakistan Ministry of Finance Statutory Regulatory Order No. 255-Law/2002/1973/Cus. Dated 19/09/2002). Except under certain circumstances, all products entering Pakistan after that date must be inspected by authorized inspection companies before delivery. Buyers must pay the government a charge equal to one percent of the consignment's assessable value to offset the government's inspection expenses. Credit will be granted only if the pre-shipment inspector in question provides an approved report. Pre-shipment inspectors, on the other hand, are contractually bound to provide accurate reports to the government, and any discrepancy may result in them being penalized (PSI Audit Agency Appointment Order, 2001, Pakistan Ministry of Finance Statutory Regulatory Order No. 246-Law/2001/1917/Cus. Dated. 29/08/2001, Pakistan Ministry of Finance Statutory Regulatory Order No. As a consequence, purchasers may feel safe throughout the examination of their products at the loading port.

Performance Bonds are used in Certain Situations

A performance bond is the greatest way for a buyer to preserve his contract with the seller. The seller guarantees the buyer's compliance with the sales contract by issuing a performance bond in his favor. By contrast, such performance would oblige the issuing bank of the performance bond to pay the buyer the bond's stated amount on demand. If a vendor offered such a strong guarantee, backed up by a bank, the danger of fraud would be minimized (Demir-Araz, 2002). Many sellers may be unwilling to arrange for a performance bond due to the cost charged by the endorsing bank, which is deducted from the seller's trading profits. If the seller requests such a bond, the seller is likely to demand a higher price for the products. Buyers must choose between increased transaction costs and transaction security.

The Fraud Exception is being Reconsidered

Contrary to documented Ls/C's autonomy, fraud is an exception. As previously mentioned, however, the fraud exception is very restricted. Courts worldwide are avoiding intervening with documentary credit transactions to maintain the documentary Ls/C's autonomy and integrity (Johnson & Paterson, 2001). Due to the high burden of proof, the fraud exception may never be utilized or may exist just as a concept. As a consequence, the fraud exception should be reconsidered to help prevent the abuse of documentary credit transactions (Demir-Araz, 2002). Concerned courts may pursue fraudsters if they do not impinge on the autonomy of Ls/C in suspending payment, jeopardizing the credit's basic goal of financial assurance in international trade. Swindlers may be able to conceal their tracks if an international agreement prohibiting their prosecution is in place.

The International Criminal Court's Commercial Crime Service

Commercial Crime Service (CCS) is an arm of the International Chamber of Commerce that provides complimentary services to its member institutions. Banks may always submit compliant documents to CCS for validation before paying the recipient. CCS maintains a database of different pieces of information supplied from across the world, and CCS members have a wider exposure to the global business market when it comes to determining the validity of documents. The danger of being duped may be minimized by having papers validated by CSS before the discussion.

Submission of Conforming Documents through Electronic Transmission

Credit transactions are filled with excessive quantities of paperwork, whose annual global cost is tremendous, and the process is inefficient, time-consuming, and prone to fraud, among other things (Christensen, 2003). Bolero, a cross-industry utility platform for the secure electronic transfer of information, was established in late 1999 to solve the problems of worldwide trade. The Bolero project was established to address these concerns in international business. BOLERO is a cross-industry initiative that is co-owned by SWIFT, a cooperative owned by the world's banks that facilitates inter-bank messaging service, and TT Club (Transportation Technology Club), which is a mutual insurer for ship owners, freight forwarders, terminal operators, and port authorities. SWIFT and TT Club are both members of the International Chamber of Commerce (Godier, 2000). The Bolero project is being created to make it easier to show trade documents that have been recorded on the internet. Bolero may be beneficial for a variety of reasons, including the secure transfer of documents in electronic form, the removal of paper labor, and the reduction of the likelihood of fraud occurring. The International Chamber of Commerce (ICC) has previously published a guideline known as the UCP, which is intended to address the legal framework that is needed for submitting conforming documents online to be accepted (Bryne & Taylor, 2002). However, Bolero does not offer a free service for submitting papers online, unlike some other companies. To avoid being duped in documentary credit transactions, it is recommended that the buyer, the seller, and the appropriate institutions all contribute to this little cost. The Bolero project has the potential to be a viable solution to the issue of documentation credit fraud if it is implemented successfully.

CONCLUSION

To summaries, there is no one solution to the recorded Ls/C transaction fraud issue. Documentary credit fraud would not be completely absent from international trade. International merchants and regulatory authorities cannot just stand by in amazement and blame legal processes for allowing criminals to get away with it. Many courts throughout the world have been reluctant to interfere in L/C transactions to allow the guarantee to be honoured without intervention. If courts issue restraining orders against the payment of documentary letters of credit regularly, the credit may lose its role as a financial guarantee in international trade. Banks, on the other hand, would suffer irreparable damage if courts barred them from executing banking contracts, perhaps resulting in excessive banker's guarantees in international trade.

For whatever reason, fraud in documentary letters of credit should be reduced *via* a variety of means, including the use of independent inspectors, quality certifications, and electronic filing of conforming documents. This would raise the trading costs of the parties involved somewhat, but it may help prevent fraud. Regular court involvement with Ls/C, on the other hand, would do little to reduce fraud; instead, it would undermine trust and confidence in international trade.

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