

The Risk and Prevention of Letter of Credit Fraud

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Abstract: Letter of Credit (L / C) settlement method is a major settlement method in international trade. Under the letter of credit settlement method, the bank acts as an “intermediary” between the buyer and the seller and promises to obtain the payment from the bank as long as the seller submits the required documents in accordance with the letter of credit. Get the goods. Therefore, the letter of credit is a kind of bank credit. This kind of bank credit solves the concerns of buyers and sellers on payment and delivery to a great extent, making the letter of credit an important settlement method in international trade settlement. However, under the settlement of the letter of credit, the letter of credit and the contract are independent of each other, and the bank manages the “single” regardless of the “goods”, and there are many types of letters of credit. The banks involved include the issuing bank, negotiation bank, notification bank, and reimbursement bank. Waiting for multiple banks, these banks do not necessarily know each other, coupled with the long transaction time, there are also many risks.

1. Introduction

A BOC once received a letter of credit from a Hong Kong AB financial company with a trading company in Shandong as the beneficiary, the amount was USD 395,000, and the exported goods were 20,000 square meters of carpet. The letter of credit requires that the importer's designated representative issue a cargo inspection certificate before shipment, and its signature must be confirmed by the issuing bank, and 1/3 of the original bill of lading is required to be delivered to the importer's representative after shipment. At the time of shipment, the representative of the importer came to the place of shipment, provided an inspection certificate, and took several large checks as collateral, and took one of the original bills of lading from the exporter. Later, the exporter entrusted the relevant check to the local bank for negotiation, but the result was told that “the collected check was a blank check, and the signature of the inspection certificate issued by the importer's representative did not match, it was purely counterfeit.” At this time, all the goods have been taken away and the whereabouts are unknown. The exporter suffered fraudulent losses.

In the letter of credit transaction, because it is impossible for the bank to investigate the real situation of each international trade, the letter of credit settlement follows the letter of credit independent principle and “single document conformity, single conformity” eight-character principle. This has provided soil for fraud to a certain extent. Some criminals have used this feature to carry out fraudulent activities, which has caused the victims, especially some small and medium-sized business traders in China, to suffer heavy losses. It needs to be highly valued by enterprises. There are various ways of fraud in the letter of credit. This article analyzes from three aspects: importer, exporter and bank.

2. Fraud Faced by Importers and Its Prevention

A letter of credit is a document transaction. In the form of letter of credit, the bank processes the documents. As long as the documents submitted by the beneficiary appear to conform to the provisions of the letter of credit, the bank has to pay. The bank is not responsible for the format, completeness, accuracy, authenticity, falsification or legal validity of any document, or the general or special conditions specified or attached to the document; for the description, quantity, quantity,

and description of the goods represented by any document Weight, quality, condition, packaging, delivery, value or existence, or the integrity or conduct or omission, solvency, ability to perform or of the goods consignor, carrier, transporter, consignee or insurer or anyone else Credit status is also not responsible. In this way, exporters who rely on forged documents, shoddy goods, or no goods at all to defraud them by apparently conforming documents have an opportunity. This is the most typical situation in letter of credit fraud.

2.1 Exporters Forged Documents or Submitted False Documents

In this kind of fraud, the common situation is that the seller simply does not have or is unwilling to deliver the goods stipulated in the sales contract, but forges fake bills of lading (collusion with the carrier) and other relevant documents to defraud the bank of the goods. At present, there is no uniform fixed format for the bills negotiated by the bank, and it is very easy to forge, and the importer sometimes has difficulty in distinguishing the authenticity of many documents.

2.2 The Goods Delivered by the Exporter Are Worthless

The exporter deliberately defrauded the payment, premeditating to replace the goods under the contract with valueless goods in a very covert way. If it cannot be checked out, then the money under the credit of the importer can be defrauded.

2.3 The Exporter Exchanges the Guarantee for a Clean Bill of Lading

In maritime transportation, importers and banks generally will not accept unclean bills of lading that record the condition of the goods when they are shipped on the surface, or add relevant cargo damage or poor packaging. When the goods or packaging are defective, there will often be cases where the exporter and the carrier colluded with the fraudulent consignee and exchanged a clean bill of lading with a guarantee to facilitate the smooth settlement of the foreign exchange. When the importer finds that the goods do not match, the payment has already been lost.

2.4 Colluding with the Parties to Swindle the Goods

The exporter and other relevant parties conspired to resell the goods midway for fraud. That is, the exporter collaborates with the carrier, and after the shipment is completed or shipped, the partner unloads the goods to another port and resells the goods in private, and it is said that the cargo is damaged or the carrier and the ship “disappear” together.

In view of the above risks of fraud in the letter of credit, the importer can prevent from the following aspects in the business.

2.4.1 Choose Trading Partners Carefully

The fact that exporters make fake documents or goods that report less and report more than those that are good is largely related to their honesty and credit and business ethics. Therefore, for the buyer, the reliable credit of the trading partner is an important part of the fraud prevention of the letter of credit. Before the transaction, the buyer should investigate the credit of the seller's credit evaluation agency, chamber of commerce, and other specialized agencies, and establish a complete customer information file for future inquiry. In the transaction, I often communicate with the salesperson to give guidance and help to the doubtful and difficult problems that the salesperson has in the transaction process. After the transaction, the accounts receivable and unreceivable are used as monitoring methods to prevent the occurrence of bad debts. In this way, risks can be avoided to the greatest extent possible, and the business can proceed smoothly.

2.4.2 Add Self-Protection Clauses in the Letter of Credit

Importers can set clear and specific requirements on commercial invoices, bills of lading, insurance policies, certificates of origin, commodity inspection certificates, etc. in the letter of credit, to prevent exporters from using the rough and vague terms of the letter of credit to submit documents that meet the requirements of the letter of credit but do not meet The documents required by the contract are used for fraudulent payment. If the pre-shipment inspection is used to determine

the quality of the goods, the exporter may be required to provide an inspection certificate issued by an authoritative organization such as SGS (Swiss General Appraisal Company), or it may send someone to personally inspect and supervise the shipment to ensure that satisfactory imported goods are obtained.

2.4.3 Choose the Right Trade Terms

When entering into a sales contract, the importer can choose FOB price terms. Because, under FOB terms, the buyer can choose a company with good credit to carry the goods, and choose a reliable insurance company to insure, to the greatest extent to prevent the seller from fraudulent behaviors that are sub-good and fake. Even if fraud still occurs, for example, the ship sent is not loaded, the seller has already settled the foreign exchange, and the buyer can take immediate action, that is, request the bank to refuse payment or apply to the court for an injunction, and the action will be timely. Although the proof requirements for allegations of fraud are high, the buyer will not have much difficulty under FOB conditions, because it is the ship he sent that it is relatively easy to prove that it has never been loaded or a pile of waste. .

2.4.4 Improve the Quality of Business Personnel and Enhance Risk Prevention Awareness

To refrain from the fraud of letters of credit known as “high IQ crimes”, the buyer's business personnel must have a considerable degree of economic and trade and legal knowledge and rich practical experience. To this end, importers should pay attention to the quality training of business personnel, enhance their risk prevention awareness, and formulate a complete internal credit and risk management system. Foreign trade business personnel should earnestly learn professional knowledge and continuously improve their business level, which is the key to preventing risks.

3. Fraud Faced by Exporters and Its Prevention

Although the letter of credit is a “bank credit”, it is not a 100% guarantee for the exporter to receive the payment. Among them, “fraud” has to be prevented. The case cited at the beginning of this article is the case of importer fraud encountered by exporters due to negligence or inexperience.

The risks of credit fraud for exporters are:

3.1 Forged Letter of Credit

The importer uses the forged or altered letter of credit to bypass the notification bank and send the exporter directly, or use the forged, altered or invalid letter of credit as a guarantee to defraud the bank and open another letter of credit to lure the exporter to ship and deceive the goods; Or the importer colluded maliciously with the bank employee who was bankrupt or close to bankruptcy, opened a letter of credit, etc. and sent it directly to the exporter. If the exporter was paralyzed, it would result in the loss of goods and money. This requires special attention from exporters.

3.2 “oft Terms”

This type of letter of credit generally sets certain “soft terms”. If the exporter does not carefully review or modify it, it may be refused to pay when paying the bill. At this time, the goods have been shipped away, and the final exporter A blank “. In practice, typical “soft terms” include: ① The letter of credit is not in effect temporarily; ②Regulate that the filling of a certain content in a document is subject to the letter of credit modification notice. Confirmed after the modification of the letter of credit; ③Customer inspection clauses, that is, the goods must be inspected by the applicant before the issuance of the goods, and the quality certificate issued after the inspection is qualified as one of the negotiation documents; ④ the letter of credit to the bank's payment and acceptance behavior It stipulates certain prerequisites, such as the issuing bank must pay the goods after the goods have passed the inspection; ⑤ The letter of credit stipulates some provisions that cannot be carried out in accordance with the normal procedures without instructions. The port of loading and unloading requires the applicant's consent to open the permit. Therefore, the exporter

must be careful when reviewing the letter of credit to prevent fraud.

3.3 Fraud Sending Original Bill of Lading

In offshore trade, the goods often reach the destination faster than the shipping documents under the letter of credit. In order to avoid delays in delivery, the letter of credit provides that “1/3 of the original bill of lading is sent directly to the applicant, and 2/3 of the original bill of lading is submitted. Bank negotiation “. If the importer colludes with the shipping company and takes the goods in advance, it may no longer pay the redemption; and as long as any one of the three original bills of lading is used to pick up the goods, the other two will automatically lapse and the exporter may will suffer great losses.

3.4 The Letter of Credit Clauses That Are Different from the Contract

When an importer opens a letter of credit, it sets different terms in the letter of credit than the contract. Changes in the terms of the letter of credit do not mean that the terms of the contract are similarly modified. At this time, if the exporter as the beneficiary is handled according to the letter of credit, it may grant the other party to handle it and make a claim for compensation in the name of breach of contract.

In response to the above risks of fraud in letters of credit, exporters should pay attention to the following precautions in addition to carefully selecting trading partners and improving the quality of business personnel in their business.

3.4.1 Regulate the Collection of Certificates and Prevent Importers from Using Fraudulent Letters of Credit for Fraud

In accordance with the Uniform Customs for Documentary Credits (UCP600), the notifying bank is obliged to verify the authenticity of the notified credits. Therefore, exporters need not worry too much about the identification of false letters of credit. However, if you receive a letter of credit sent directly by the importer, you must go to the bank to verify the seal, and do not easily ship the goods before the seal and the custody are verified, to prevent the importer from falsely issuing the certificate with the issuing bank. Or through certain third-country “relationship” banks to notify the beneficiary banks of letters of credit, and thus encounter the risk that the issuer is a non-bank financial institution. In recent years, both exporters in the mainland and Taiwan have encountered similar frauds, and the ICC China Committee has issued risk warnings several times in recent years.

3.4.2 Strengthen the Work of Certification and Billing

After receiving the letter of credit, the exporter should carefully review the letter of credit, check whether the terms are consistent with the contract, and carefully study whether the terms of the letter of credit can be handled, so that the “certificate is consistent” and eliminate possible risks in the bud. After discovering the problem, you should contact the applicant of the issuance of the certificate immediately, and promptly request the client to change the certificate if necessary. Making orders in strict accordance with the requirements of the letter of credit is a prerequisite for the beneficiary to safely collect foreign exchange. In the process of making orders, we must strictly abide by the eight-character principle of “conformance of documents and conformity of single orders” to prevent discrepancies and affect the safe receipt of foreign exchange.

3.4.3 Prevention of “Soft Terms” Letter of Credit

In dealing with “soft terms”, exporters should pay attention to: ① Check the terms of export contracts. The terms of the letter of credit are issued in accordance with the terms of the contract, and the export contract is strictly stipulated, so the possibility of “soft terms” in the letter of credit is greatly reduced. ② As much as possible, the applicants are required to issue certificates from some large and reputable banks. Because these banks generally pay great attention to their reputation, they generally do not easily open letters of credit containing “soft terms”, so that the risks are relatively small. ③ Once the soft terms are found, the applicant should be asked to modify them immediately. Before the soft terms in the letter of credit have not been effectively dealt with in the

interest of the seller, do not rush to prepare the shipment to avoid major losses.

The case cited at the beginning of this article, the letter of credit requires that the importer's designated representative issue a cargo inspection certificate before shipment, and its signature must be confirmed by the issuing bank, that is, it belongs to the "soft clause", and also provides for 1/3 of the original bill of lading to be shipped Later hand in with the importer representative. For these "problem clauses", unfortunately, exporters failed to find and modify, and eventually suffered fraud losses.

4. Fraud Faced by Banks and Its Prevention

The letter of credit was issued by the bank at the request of the importer. In a certain sense, a letter of credit is a contract between a bank and an importer. Since it is a contract, there will be risks. The risks faced by banks in the fraud of letters of credit are:

4.1 Fraud of False Letters of Credit

This is the case where the importer and exporter conspire to defraud the issuing bank or the negotiating bank. For example, the importer A issued an irrevocable letter of credit to the exporter C through the issuing bank B. This letter of credit has no flaws in terms of bank review, and it is authentic on the surface and has no trap clauses. Company C used this letter of credit as collateral to apply for packaged loans from Bank D, the export destination. Apparently, the purpose of Company C's loan was to purchase goods in order to fulfill the letter of credit, but he did not purchase the goods at all after obtaining the loan from the bank. Company disappeared after dividing the loan. As a result, Company C did not submit the documents at all, and Company A did not urge Company C to deliver the goods. Bank D, which issued the packaged loans, did not receive the documents under the letter of credit, and could not claim compensation from the issuing bank at all. In addition to this case, there is also a situation where the importer and the exporter fabricate a fake transaction, the so-called seller submits a forged document to the issuing bank to defraud the bank's letter of credit, and then the fraudulent parties divide the stolen money and flee, and the issuing bank has nowhere to recover External payment.

4.2 Document Fraud

Document fraud means that the documents submitted by the beneficiary to the bank may conceal the truth or forgery. Its purpose is to hope to improperly obtain the payment under the letter of credit by presenting the documents that seem to meet the requirements of the letter of credit. For example: forged bill of lading, the beneficiary exchanges the guarantee for the bill of lading, pre-borrow bill of lading, reverse bill of lading, collude with the carrier to release the goods without the bill, forgery inspection verification and insurance policy.

4.3 The Importer Defrauds the Issuing Bank by Bankruptcy

According to the independence of the letter of credit, the bankruptcy of the applicant of the issuance cannot lead the issuing bank to release the payment responsibility to the beneficiary. Therefore, the issuing bank had to pay the beneficiary even if the issuing applicant went bankrupt. Although the issuing bank has the right to take ownership of the imported goods and can dispose of the goods freely, the bank also has to change from the role of "middleman" to the role of "buyer" and bear all the risks that the importer must bear. If the goods are not enough to make up for the loss, the bank also has to participate in the importer's bankruptcy proceedings, which takes time, effort, and money.

In response to the above credit letter fraud risks, banks should pay attention to the following precautions when conducting business.

4.3.1 Strictly Implement the Issuance Procedures, and Each Bank Performs Its Duties

After receiving the application for issuance, the issuing bank should carefully examine the payment ability of the applicant, strictly control the credit limit, and increase the margin ratio for

applicants with low creditworthiness to implement effective guarantees. After receiving the letter of credit, the notifying bank should carefully check the secret or seal of the letter of credit and verify its authenticity. After receiving the documents, the negotiating bank should carefully review the negotiating documents carefully to ensure safe and timely receipt of foreign exchange.

4.3.2 Strictly Review Letters of Credit and Documents, and Strengthen the Prevention of False Letters of Credit and “Soft Clause” Letters of Credit

The credit fraud risks faced by banks mainly come from the frauds implemented by importers and exporters using false letters of credit alone or in conspiracy, as well as the harmful consequences of the banks' own inadequate review of fraudulent letters of credit or documents. Therefore, the issuing bank should carry out a meticulous verification of the letter of credit and strengthen the review of the bills negotiated under the letter of credit. In addition, the notification bank should also assist the exporter in identifying the “soft terms” of the letter of credit. Once the importer finds that the letter of credit is suspected of having soft terms, it should remind the exporter to modify the letter of credit.

4.3.3 Pay Close Attention to Abnormal Phenomena That May Occur in the Letter of Credit Transaction

In the process of implementing a letter of credit fraud, there are often warning signs that bank business personnel should pay close attention to. Common anomalies are: traders can obtain higher profits, but the risks they take are very low; suddenly a large amount of goods are bought and sold without any aura or reliable background in advance; the price of the goods is seriously Underestimation and low prices are often related to fraud; letters of credit do not require shipping documents, etc., although they involve the movement of goods. After discovering the above-mentioned abnormal phenomenon, the bank shall notify the relevant parties or institutions as soon as possible for further verification in order to prevent the fraud of letters of credit by illegal enterprises.

4.3.4 Strive to Improve the Quality of Bank Business Personnel and Improve Business Management

The key to the effectiveness of the above precautions lies in the business level of bank employees. On the one hand, banks should unremittingly strengthen the cultivation of business knowledge and skills of employees, and strive to improve their quality; on the other hand, they should establish a perfect business process control and management system, requiring document personnel to strictly abide by when handling business, Act in accordance with the regulations, implement the prevention system, and control operational risks.

In summary, although the settlement of letters of credit provides “bank credit”, it is not an impeccable payment method. In the credit business, due to the intervention of bank credit, the credit becomes easier to be accepted by all parties to the transaction, but commercial credit still plays a role in the settlement process of the credit. Bank credit cannot completely replace commercial credit, nor can it completely avoid commercial risks. The credit settlement method itself is neutral and can be good or evil. The important thing is who will use it and how to use it. In the article “Prevention of Financial Fraud,” Eric Ellen, Director of the International Maritime Administration, pointed out that 95% of trade fraud can be avoided by traders with due care. Therefore, the best way to deal with LC fraud is to take precautions. When adopting L / C settlement, Chinese enterprises should enhance risk awareness, strictly regulate business, improve the business level and practical experience of foreign trade enterprises and banks, and prevent fraud.

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