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HOW CAN BANKS RECOGNIZE DIVERSION SCHEMES?

Banks are rarely held liable for losses in diversion schemes, but their customers C the manufacturers exporting wares overseas C can be badly hit by this common form of fraud in letter of credit documents and transactions. Donald deKieffer, an international trade regulation attorney and a partner in the Washington, D.C., law firm deKieffer and Horgan, estimates that of the US$ 22 billion in goods returned to the United States each year, roughly US$ 12 billion comes back because of diversion schemes. And he believes that the incidents of diversion are increasing.

What Is Diversion?

Diversion is the practice of fraudulently returning goods intended for overseas sales to the U.S. market, where the goods are bought at the discounted price offered to non-U.S. customers. Sometimes diverters send the goods to the intended destination and then have them returned to the United States, allowing the goods to be purchased at bargain-basement prices. Or diverters might counterfeit bills of lading and other shipping documents so the goods seem to have been sent overseas, although in reality they never left the American port.

This type of fraud, says deKieffer, is easy to commit: "Passing phony documents for a letter of credit is much easier than passing a phony $20 bill. In 20 minutes, anyone can create a false bill of lading on their home computer. The bank would never know."

Generally, banks are not liable for losses from diversion. "There's all kinds of legislation protecting banks," says deKieffer. However, he encourages banks to educate their export customers about types of coding that could truly authenticate bills of lading. Some banks, he says, do have programs that ask for a code or marking on the shipping documents before the letter of credit is honored.

What Can Banks Do?

Noel Hillman, assistant U.S. attorney for the district of New Jersey, has tried several diversion cases. He notes that diversion typically involves letters of credit.

"In order to avoid being unwittingly involved in a diversion scheme, banks would do well to insist on proof that goods are actually delivered to the ports," says Hillman. He points out that in one common scam, the goods never leave port and the receipt documents are falsified. "The more that the letter of credit requires before payment, the more likely it is that banks are involved in a legitimate transaction," he says. Specifically, he advises banks to ask for shipping documents when issuing letters of credit, rather than simply making do with invoices.

Banks should be wary, says Hillman, of customers who routinely purchase letters of credit that are not drawn upon.
Often, he says, letters of credit are used to lend the appearance of legitimacy to a shady deal. "If a company is always in the habit of getting a letter of credit and paying from cash from other sources," he says, "a bank should be concerned that the letter of credit is being used simply as part of the fraud."

Although banks can do their part, it is the manufacturer who stands to lose. In diversion, says Hillman, “it’s the manufacturers who should be more diligent. If they get a letter of credit that’s skimpy, they would do well to ask for more documentation.”