



The efforts of the fraud prevention harming banks in the transactions of letter of credit

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Abstract

Government Regulation of the Republic of Indonesia Number 1 of 1982 concerning Export, Import, and/or Foreign Exchange Transaction has not regulated the use of Letter of Credit (L/C) comprehensively. Using L/C as a payment method has a variety of risks. One of them is fraud, both caused by external and internal factors in banking. Most of cases of L/C caused by fraud in Indonesia involve the game of internal bank parties for personal or some parties' interests so that it causes considerable losses. This article would focus on the cases that occurred at PT Bank Negara Indonesia (Persero) Tbk which came up in 2003 and Century Bank in 2009. The efforts of the prevention are needed so that cases of fraud in L/C activities in the future can be avoided, both carried out by the banking parties as an agency and the establishment of more comprehensive regulations governing L/C.

Keywords: letter of credit, fraud, legal protection, export import, banking

1. Introduction

Every person can freely obtain and use foreign exchange as confirmed in Article 1 of the Government Regulation of the Republic of Indonesia Number 1 of 1982 concerning the Implementation of Exports, Imports and Foreign Exchange Traffic. The foreign exchange sources intended in the article include the foreign exchange sources from the results of international trades that are often carried out by the entrepreneurs in Indonesia by doing export import activities from and to other countries.

International trade is a risky activity. To manage risk and limit exposure in selling and buying overseas, the companies can use Letter of Credit (L/C) offered by banks ^[1]. L/C or documented credit letters can provide security to both parties, namely for the seller (exporter) to feel safe because there is certainty of the payment from the buyer (importer) of the delivered goods ^[2]. Letter of Credit is a form of commonly international payment because it provides high protection for both exporters and importers ^[3].

However, many cases has currently occurred in which small or large entrepreneurs used the active L/C for personal businesses that caused huge losses. Besides, there was also breach of agreement that has been determined by those entrepreneurs. The growing development of increasingly modern trade has made the entrepreneurs who do not have good intention in carrying out an agreement carry out more breaches in the transactions using L/C that can harm the banks in Indonesia. However, it should be prevented if there are preventive actions for the bank parties that have been harmed.

According to Phillipus M. Hadjon, legal protection for the people is the preventive and repressive actions of the government ^[4]. The preventive legal protection is aimed to prevent disputes, direct the government actions to be careful in making decisions based on discretion, and the repressive protection is aimed to prevent disputes, including handling them in the judiciary ^[5].

Law must provide protection for all parties in accordance with their legal status because everyone has an equal

position before the law. Development in the field of law is intended to ensure that the community can enjoy legal certainty and legal protection which have the essence of justice and truth ^[6].

There are researches related to Letter of Credit both articles written in journals and books. According to the author, one of the most interesting researches is a research conducted by Ramlan Ginting in 2007 entitling Letter of Credit: the review of legal and business aspects. However, the research did not contain legal protection for correspondent banks in the transactions of international trade. In this article, the writer would like to analyze and find out deeply regarding legal protection for correspondent banks if fraud occurred in the transactions of international trade using L/C and provide alternative solutions in the term of efforts that should be carried out by both the banking parties and the new legal regulations specifically published by the government of the Republic of Indonesia concerning a more comprehensive L/C.

The occurrence of fraud in the cases of fictitious L/C as experienced by a number of banks in Indonesia that acted as the correspondent banks in the export-import trade traffic is very important to be studied in depth, especially by all the parties involved. Fraud is one of the risks that can occur in the transactions of L/C. In L/C activities, banks only deal with documents, not with goods so that the beneficiary of the L/C whose position as an exporter is very likely to commit fraud against the bank and applicant so that the related person can receive payment, but he does not deliver goods (fictitious exports) or deliver goods that are not in accordance with the agreement.

This article was aimed to provide suggestions regarding the efforts that should be done so that there will be no fraud in the transactions of L/C that can harm the banking parties, especially the correspondent banks.

2. Research Method

This article used the normative legal research method because the focus of the study came from the vagueness of

norms^[7]. It used statute approach by analyzing all laws and regulations related to the problems (legal issues) that were being faced. The data used in this research were the secondary data consisting of primary legal materials and secondary legal materials. The collected legal materials were analyzed using interactive analysis method by reducing and drawing conclusions to answer legal issues in this research.

3. Result and Discussion

3.1 Risk of Payment Using L/C

The simple concept of Letter of Credit (L/C) is taking over the payment responsibility by another party (Bank), based on the basis of the request of the Applicant or the buyer to make a payment to the recipient of the guarantee (Beneficiary) or the seller in accordance with the specified and agreed terms and conditions. The process of giving the facility of L/C is very simple. After the deal between the buyer and seller which is stated in the sales contract or other media agreement occurs, the buyer submits an application for opening L/C to the Bank that will issue the L/C (Issuing bank) based on the seller's request. In the concept of L/C, the buyer is called as an Applicant and the seller or credit applicant is called a Beneficiary^[8]. Issuing bank is the guarantor that opens L/C and gives the guarantee to the Beneficiary. Advising bank is the bank that carries on the L/C, which is the correspondent bank (agent) that proceeds the L/C to the beneficiary.

If it is compared to domestic trade, international or export-import trade has a lot more risks. Every international trade has risks that must be borne by both the sellers and buyers. The risks can cause problems, but they can also bring profitable opportunities for both companies and individuals. The risks are related to the causes of the losses that cause problems, but the actual losses can be found out so that they can be planned at the beginning to overcome them. The risks become the important problems if the caused losses cannot be found out with certainty.

The duty of the correspondent bank is to check the validity of the document from the issuing bank. If the document is in the conformity, the correspondent bank will send a letter of introduction to the entitled exporter. On the other hand, if the validity of the document is false, the correspondent bank will find out directly and not guarantee the agreed payment for the L/C. The correspondent bank can be harmed if there is an intentional element in which the internal party of the bank intentionally accepts the fictitious L/C document with the aim of benefiting themselves or a certain group.

The regulation basis of international trade transactions using L/C is Uniform Custom and Practice for Documentary Credits (UCP-DC 600). UCP-DC 600 is the legal basis of the payment regulation using L/C. Previously, commercial banks in Indonesia practically followed L/C regulations based on UCP-DC 290. This was due to the validity of Government Regulation Number 16 of 1970 concerning Improvement of Implementation of Exports Imports and Foreign Exchange Traffic of Bank Indonesia issued the Association of Provisions on Procedures of Foreign Exchange Traffic (*Himpunan Ketentuan-ketentuan Prosedur Lalu Lintas Devisa - HKPLLD*) as the provision of the implementation that required L/C received from overseas as well as those issued from Indonesia to Overseas subjected to the applicable UCP, namely UCP-290 which came into force on October 1st, 1975. Government

Regulation Number 16 of 1970 along with Government Regulation Number 11 of 1976 concerning changes to Government Regulation Number 16 of 1970, then revoked by Government Regulation Number 1 of 1982 concerning Implementation of Exports, Imports, and/or Cross-Foreign Exchange. In this regulation, it is regulated on how to export, import, guarantee, and insure in the implementation of exports and imports. However, this regulation does not regulate in detail about L/C. Because many main substances regarding L/C are not regulated in this regulation, this regulation cannot fully bind international trade transactions using a Letter of Credit (L/C).

Bank Indonesia issued Bank Indonesia Circular Letter Number 17/14/ULN dated on September 29th, 1984 that required L/C issued by foreign exchange banks in Indonesia to subject to the applicable UCP, namely UCP-400 which replaced UCP-290. Then, the Bank Indonesia Circular Letter Number 17/14/ULN was revoked with Bank Indonesia Circular Letter Number 26/34/ULN dated on December 17th, 1993 which regulated the submission of L/C to the applicable UCP, namely UCP-DC 500 which came into force on January 1st, 1994 and then, ICC Banking Commission approved changes to the regulations for the documentary credit so that UCP-600 has been effectively valid since July 1st, 2007 until now.

The case at PT Bank Negara Indonesia (Persero) Tbk was an issue that shocked the Indonesian people at the end of 2003, in which BNI suffered a loss of Rp 1.7 trillion, which allegedly occurred due to the fictitious export transactions through L/C. The case began when BNI of the Kebayoran Baru Branch received 156 L/Cs with Issuing banks: Rosbank Switzerland, Dubai Bank Kenya Ltd, The Wall Street Banking Corp, and Middle East Bank Kenya Ltd. At that time, BNI did not have a direct correspondence relationship with some of those banks. BNI decided to use mediator banks, namely American Express Bank and Standard Chartered Bank.

Beneficiaries (exporters), namely Gramarindo Group and Petindo Group, submitted an application for wesel export discount (export credit) for the L/C-L/C to BNI and be approved by BNI. Gramarindo Group received Rp 1.6 trillion and Petindo Group received Rp 105 billion^[9]. However, after some of those bills were due, the Opening Bank/Issuing Bank could not pay to BNI and the customers could not return the export proceeds that had been previously disbursed. After being investigated by the police, it found out that the export activities had never occurred. Based on the findings, Gramarindo Group had returned Rp 542 billion, the rest (Rp 1.2 trillion) was the potential loss of the BNI^[10]. The transactions at BNI were problematic transactions with the indication that the transactions were carried out without following the provisions of the internal BNI. In addition, the submitted L/C documents contained irregularities and L/C negotiations were carried out without the complete documents. Based on the investigation results carried out by the headquarters of BNI, the exporters, namely the companies including Gramarindo Group and Petindo Group had carried out fictitious exports^[11].

This was revealed from the results of the verification to the Customs and Excise Officer of the Belitung branch regarding the Export Declaration (*Pemberitahuan Ekspor Barang - PEB*) of Gramarindo Group which stated that the PEB was fake. Meanwhile, the settlement of the payment of the proceeds from several L/C slips that had been negotiated

was not carried out by the issuing bank, but by the exporters themselves by depositing or debiting the accounts of the exporters.

Another case occurred at Century Bank. PT Damar Kristal Mas or PT DKM which was engaged in goods trading and export and import business owned by Rudy Lukasanto and Tio Hui Hiong who owned 50% of each stock, in which Rudy Lukasanto served as a director and Mrs. Tio Hui Hong served as a commissioner, received special treatment for the disbursement of the L/C facilities from Century Bank. The L/C given was based on the instructions of Robert Tantular (Century Bank Stockholder) and Hernanus Hasan Muslim (Executive Director of Century Bank) based on the information from the Chairman of the Operational Headquarters (*Kantor Pusat Operasional - KPO*) of Senayan, namely Linda Wangsadinata.

The L/C facility given to PT DKM was L/C No. 0518LC08B of US\$ 10 million with collateral (margin deposit) and deposits of US\$ 1 million (or 10% of the L/C ceiling). This L/C facility was given for the import transactions of the corn production from Grains and Industrial Products Trading PTE, Ltd. as the beneficiaries based on the sales contract with the negotiating bank, Dresdner Bank Switzerland Singapore and Correspondent Bank of Dresdner Bank Switzerland Jakarta. In addition, PT DKM obtained the facility through L/C No. 0527LC08B of US\$ 5 million with collateral (margin deposit) in the form of 10% deposits from the L/C ceiling. The L/C facility was used for the import transactions of the corn production from Bunge, S.A., Geneva.

The L/C facilities were given without comprehensive analysis and procedures, especially regarding the capability or financial condition of the company. However, the L/C had been approved by the Credit Committee, both the Branch Credit Committee (Head of Operations and Branch Head), the Regional Credit Committee, and the Central Credit Committee, namely directors (Hermanus Hasan Muslim and Hamidy) and commissioners (Poerwanto Karmjadi and Rusli Prakarsa). In addition, the Credit Agreement had been signed by hand without binding guarantees.

This condition violated the Credit Policy of the Bank and Guidelines for Implementing Loans of Century Bank. Bank Century had placed a guarantee (deposit) on a correspondent bank of US\$ 25 million with details of Dresdner Bank Switzerland Jakarta of US\$ 15 million and Credit Suisse London of US\$ 10 million. The deposit of Century Bank to Dresdner Bank Switzerland Jakarta and Credit Suisse London was not comparable to the guaranteed L/C given by the debtor at US\$ 4.3 million or 20%. Collateral was reduced to US\$ 2.15 million or 10% without the approval of the Directors of Century Bank. The other guaranteed nine debtors who received the L/C facilities from Century Bank also ranged from 5% - 20% of the L/C ceiling. Initially, the margin deposit of PT DKM of 20% from the value of the L/C facilities of the foreign exchange deposit was US\$ 4.3 million, then it was reduced to 10% or US\$ 2.15 million. Based on the examination of the documents, there was no application letter for a change of guarantee. In addition, the Approval on the Guarantee Amendment was not signed by the Executive Director of Century Bank (Hermanus Hasan Muslim) and the Vice Director of Century Bank (Hamidy), as well as the Director of PT DKM (Rudy Lukasanto). Letter of Authority No.038/SK-DIR/X/08 was not signed by

the Executive Director and the Vice Director of Century Bank either. Likewise, the Letter of Approval of the Commissioner No.032/PERS-KOM/LG/X/08 was not signed by the Commissioners (Poerwanto Karmjadi and Rusli Prakarsa) ^[12].

Realization of the use of all L/Cs of US\$ 21,499,993.86 was due on April 24th, 2009, June 1st, 2009, and September 18th, 2009. However, when it was the due date, PT DKM was unable to pay the L/C obligations so that Century Bank executed the guarantee. PT DKM claimed not to use L/C, but its name was only used by Robert Tantular and Anton Tantular which was stated through a Statement Letter made by Robert Tantular. PT DKM had appointed a lawyer, ND Solid, to report to the Criminal Investigation Agency of the National Police to follow up on this issue legally.

Century Bank has also made elimination for the three L/Cs of PT DKM, US\$ 19.35 million or equivalent to Rp 230.915 billion on December 31st, 2008. Finally, this case weighed on the Temporary Capital Participation (*PMS*) by the Deposit Insurance Corporation (*LPS*). Based on these conditions, the portion of *PMS* used to cover the losses of Century Bank from the L/C facilities of PT DKM was Rp 210.915 billion, namely the elimination for PT DKM of US\$ 19.35 million or equivalent to Rp 210.915 billion. The investigation results of the Audit Board of the Republic of Indonesia (*BPK*) also noted the violations of PT DKM of Bank Credit Policy and Credit Implementation Guidelines issued by Century Bank No.20/SK-DIR/Century/IV/2005 on April 21st, 2005 due to the absences of Business Activity Plan Report (*LRKU*) and credit agreement along with other necessary bindings.

For this incident, Century Bank should not be allowed to give special treatment to any party outside the predetermined L/C provisions. In addition, the stockholders should not interfere. Comprehensive procedures are needed when it concerns the capability or financial condition of the company carried out by the concerned bank in accordance with the Bank Credit Policy and Implementation Guidelines of Bank Credit.

UCP does not regulate legal options to resolve L/C cases. The parties only adopt a set of provisions relating to the implementation of procedures from L/C in the UCP, and the UCP is not the only applicable legal choice to L/C even UCP and National Law that can simultaneously be a legal choice for L/C. The regulation of legal choice in the L/C transactions is not as simple as the determination of legal choice in the general contracts. This is because the L/C transactions involve several contracts related to each other which basically consist of sales contracts, requests for issuance of L/C, L/C, and each contract has the different parties. The limitation of legal choice occurs because the parties make a legal choice based on the freedom of contract, which must be respected and not be contradictory to the public order. The conception of the public order differs from one country to another. According to the Supreme Court regulation No. 1 of 1990 concerning the procedures for implementing foreign arbitration decisions, public order is a fundamental joint of the entire legal system and society in Indonesia.

Those two cases showed that fraud cases occurred because of the internal banking itself. Intentional element was found out, in which the internal parties of the bank intended to benefit themselves or a group of people.

3.2 The efforts of the fraud prevention harming banks in the transactions of letter of credit

Government Regulation No. 1 of 1982 concerning the Implementation of Exports, Imports, and Foreign Exchange Traffic is a legal basis for L/C in Indonesia. Besides, there is also Bank Indonesia Regulation 5/11/PBI/2003 concerning the Payment of the Import Transactions which states that the payment of the import transactions is carried out by using L/C or without L/C. However, those two regulations cannot be the guidelines of the L/C implementation because the government regulation does not contain the detailed rules about L/C.

Considering that the use of L/C has so far been relied on by the entrepreneurs of the international trade, it is necessary to optimize the implementation of the regulations on the use of L/C.

The steps that should be followed up are as follows:

3.2.1 Implementing Good Corporate Governance (GCG) consistently

The implementation of GCG principles is inseparable from the adherence of the business management towards the management system correctly and all applicable legal regulations, both towards legal regulations in the form of laws and regulations, government policies, Bank Indonesia legal instruments, and internal banking legal regulations^[13].

In general, in the Banking Law, the provisions relating to GCG have been regulated which are then specifically regulated in PBI No. 8/4/PBI/2006 as amended with PBI No 8/14/PBI/2006 concerning GCG, consisting of: the first, fit and proper test, which regulates the need to improve the competence and integrity of the banking management through the fit and proper test towards the owners, controlling stockholders, board of commissioners, directors, and bank executive officers in the activities of the bank management. The second is the independence of the bank management, in which the members of the board of commissioners and directors must not have kinship relationship or financial relations with the board of commissioners and directors or become controlling stockholders in other companies. The third is the provisions for the director of the decency and improvement of the audit function of the commercial banks. In the standard implementation of the internal audit function of the commercial banks, banks are required to appoint a director of compliance who is responsible for the bank compliance towards the existing regulations^[14].

The provisions of GCG have not been able to support the banking corporate governance as expected, especially in the term of the decision making performance^[15]. This is due to the absence of adequate legal information system.

The implementation of GCG principles is a must for an institution, including the banking institution. This is aimed more at the existence of public accountability related to the operational activities of the banks that are expected to truly obey the provisions outlined in positive law.

In Article 1 number 6 of Bank Indonesia Regulation No.8/4/PBI/2006 concerning the Implementation of Good Corporate Governance for the Commercial Banks, good corporate governance is states as the banking governance which implements the principles of transparency, accountability, responsibility, independency, and fairness.

After the banking supervision function was taken over by the Financial Services Authority (*Otoritas Jasa Keuangan* -

OJK), *OJK* issued the Financial Services Authority Regulation (*Peraturan Otoritas Jasa Keuangan - POJK*) Number 55/POJK.03/2016 concerning the Implementation of Governance for Commercial Banks, hereinafter referred to as *POJK* for the Commercial Banks Governance. *POJK* was issued to improve the performance of the banks, protect the interests of the Stakeholders, and improve compliance towards laws and regulations as well as the applicable ethical values in the banking industries. Banks are required to carry out the business activities based on the good governance principles which are essentially the same as the principles contained in Article 1 number 6 of Bank Indonesia Regulation No.8/4/PBI/2006 concerning the Implementation of Good Corporate Governance for the Commercial Banks.

3.2.2 Strengthening Internal Control

The fraud cases in the banking world often occur and are carried out by anyone, both the external and internal parties of the bank itself. Internal control system is the very important thing used by the banking parties to be able to run the wheel of business properly without illegal actions being carried out to seek profit.

Internal control is a process which is carried out by the board of directors, management, and other personnel in an entity, which is designed to provide adequate confidence regarding the achievement of goals^[16].

3.2.3 Referring to the best practice and UCP in handling the L/C transactions

3.2.4 Enforcing tiered rules of authority in deciding the L/C facilities for the export-import activities

3.2.5 The government is expected to be able to issue the more comprehensive legal regulation concerning the implementation of exports, imports, and/or foreign exchange traffic that regulates L/C. The regulation also has a role to provide the legal protection for the parties, especially the banking parties that are often harmed, and a sense of justice for all the interested parties

4. Conclusion

The fraud cases in the L/C transactions often harm the correspondent banks that act as an agent to proceed the L/C to the beneficiary. The fictitious L/C or the forgery of the L/C documents are the ways that are often found in the fraud cases. Those cases often involve the internal parties of the banking itself that abuse the authority with the aim of benefiting themselves or a group of people.

To prevent the similar cases in the future, it is necessary to optimize the implementation of the regulations on the use of L/C. The steps that should be followed up are as follows:

1. Implementing Good Corporate Governance consistently.
2. Strengthening Internal Control.
3. Referring to the best practice and UCP in handling the L/C transactions.
4. Enforcing tiered rules of authority in deciding the L/C facilities for the export-import activities.
5. The government is expected to be able to issue the more comprehensive legal regulation concerning the implementation of exports, imports, and/or foreign exchange traffic that regulates L/C. The regulation also has a role to provide the legal protection for the parties,

especially the banking parties that are often harmed, and a sense of justice for all the interested parties.

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