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FRAUDS IN INTERNATIONAL TRADE

In recent months, international trade has been affected by frauds in many fields, such as in trade of goods, services, investments, marine insurance, and insurance of export trade. Even though frauds in trade are not a novelty, computerisation and the Internet have contributed to the spreading of fraudulent practices. International trade is also threatened by cybercrime. Nowadays, combating all kinds of frauds has become indispensable.

This article deals with all aspects of fraud which represent an evident danger to international trade. Particular attention was paid to the fraud detection and prevention. It is indicated that in that respect, new regulations should be enacted and legal culture should be improved.

Key words: *international trade, fraud, deceit, detection and prevention*

1. Introduction

There is no mistake without ignorance and no fraud without a mistake. Frauds as well as errors distort legal and factual circumstances derived from the behaviour of the other contractual party. The contract tainted by fraud is void. A fraud committed by the assured vitiates a contract and the insurer is often not liable to return any premium paid.

Any fraud, and thus the fraud in international trade, poses a danger to the society at large. As trust among society members increases, society generally becomes more reliable. However, if to a certain extent fraud becomes more acceptable, as it is currently maintained, this will create problems that will not resolve themselves. To that extent, some states are enacting particular laws. It should be acknowledged that we live in an environment permeated by “culture of compensation”. When in situation to obtain damages, any contractor will, either by contract or tort, often do it for a considerably higher amount than he is entitled to.

When investigating frauds in international trade, two interconnected issues should be taken into account. Firstly, the wealth of the commercial world can be found in promises which the contracting parties had never intended to keep, or even if they had wanted to, they subsequently changed their minds. And secondly, the largest wealth of the commercial world is found in the said promises. If we look for these promises, we can mostly find them in documents. In fraudulent practices, commercial documents are regularly used. Forged documents usually falsely specify the existence of goods and their agreed quantity or quality.

The laws governing binding contractual obligations stipulate express provisions to safeguard the involved parties against frauds. The French law (Code Civil, Art. 1116) stipulates that the fraud exists when it is the result of the schemes of one of the parties. The Swiss law (Code of Obligations, Art. 28) sets forth that the concluded contract is not binding when the party was induced to enter into a contract by the fraud of the other party. The innocent party can, at any time, request that the contract is annulled in the court of law.

UNCITRAL has become aware of the widespread commercial frauds and their significant worldwide impact. The general opinion is that education and training could play important roles in fraud prevention, whereas the identification of common warning signs and indicators of commercial fraud could be particularly useful in combating fraud. Additionally, it is important to protect innocent policyholders.

2. Fraud Defined

It would not be appropriate to provide a strictly legal definition of a commercial fraud. Thus, it is more suitable to look for a descriptive definition which outlines the main elements of particular frauds. The fraud is about creating false confidence and making people believe in something that does not exist. Fraud laws cover a wide range of crimes as civil tort actions that address

situations in which a person wrongfully obtains money or other benefits by deceit. In the criminal context, fraud is typically charged as a felony. In civil court, financial compensation is generally the plaintiff's sole remedy. It should be quite clear that the victim's loss resulted from defendant's actions. The dark side of fraudsters is that they see other people as objects.

3. Fraudulent Activities

To defraud is to deprive by deceit, that is, to induce a course of action. Fraud can be a difficult thing to define in the ethics of trading, which are essentially the ethics of deceiving the other side. Therefore, it is essential to understand common types of fraud occurring in international trade.

Fraudsters may try to steal your goods, business identity, etc. This is always a person, natural or legal, who is perpetrating, or attempting to perpetrate a fraud. The examination of various indicators has revealed that in many different cases, the fraud exists. Ace Europe heralded international efforts that fraudsters should be jailed. The first type of fraud in the Common Market (now the EU) was in avoiding a levy or customs duty and obtaining a subsidy or a grant.

4. Organizations Engaged in Fraud Detection and Prevention

Among the institutions which deal with frauds in international trade, there is also the International Chamber of Commerce in Paris which, for these purposes, in 1981 established the International Maritime Bureau as non-governmental body. This is a not-for-profit organization which aims at preventing frauds in international maritime carriage, collecting relevant data concerning frauds and, in particular cases, giving advice and providing education to their members. There are other organizations engaged in this field including INTERPOL, ICC Commercial Crime Services, International Union of Marine Insurance (IUMI), Salvage Association, Maritime Fraud Prevention Exchange and others. The European Anti-Fraud Office (OLAF) of the European Union is in charge of protecting financial interests of the EU budget. OLAF has prepared anti-fraud policy the objectives of which are to fight against fraud and corruption.

5. Document Fraud

Commercial documents, in particular shipping documents, are a favourite target of fraudsters. Commercial fraud always involves the issuance of, use of, or reliance on documents that are not typically used in the type of transaction to which they are intended to relate, or on documents that contain irregularities. The starting point to investigate these frauds are documents involved in trade transaction.

Document fraud most commonly appears in the following forms: copying a false document, using a false document, using a copy of a false document and suppression of documents. There is a conceptual distinction between a document that is a forgery and one that contains false information. A forged document, such as a certificate, executed by a random instead of designated surveyor, is a nullity.

a. Bill of Lading

The bill of lading performs three important functions. Firstly, it is a document of title, enabling the holder or his endorsee to claim goods. Secondly, it is a receipt for the goods which have been delivered to the carrier. Thirdly, it is an evidence that the contract has been entered into between the shipper and the carrier (who is often the owner of the ship). The bill of lading is very often used for the purposes of perpetrating frauds. It is believed that in future, this document should be avoided, whenever convenient, and replaced with another document, such as non-negotiable bill of lading or other.

The experience has shown that the bills of lading have been issued with incorrect data relating to goods shipped, (whether as in sound condition, wrong date of shipping and place where the goods were stowed). This is often the result of conspiracy between the freight forwarder, who acts as a mediator between the cargo interests (the shipper and the consignee) on the one part, and the sea carrier on the other. Forged bills of lading are used for cargo theft.

Bills of lading issued under voyage charter party were associated with the "charter party frauds". This is, for example, when the goods carried on ships can never reach destination.

The examples below refer to the arbitration and litigation cases in which the author of this paper has participated.

EXAMPLES:

The bill of lading was issued for the carriage of Chinese soya bean meals shipped on board of MV MARIZA from Dalian to Novorossiysk. The payment was arranged by the letter of credit. The efforts of the seller to collect

the payment from the bank were unsuccessful because he had submitted the copy of the bill of lading. The seller failed to collect for the second time when he submitted the copy of the bill of lading freshly sealed. On the bill of lading, besides MARIZA, subsequently appeared MV Myson. In Novorossiysk the seller succeeded to receive soya bean meals by bribing cargo handlers. Despite the warning, the sale was arranged with the unknown seller instead of being sold to well-known international companies.

The bill of lading was issued for the carriage of prime hot rolled steel coils shipped on MV AEGEAN CLIPPER from Mariupol to Kaohsiung. Aquarian Shell Marine Inc., the company which did not own the ship (known as the “disponent shipowner”), acted as a carrier. Due to a slow cargo loading, the ship left the port of loading with only half of the cargo loaded. The seller was forced to engage another ship to carry the rest of the cargo and pay additional freight. The law suit against Aquarian had to be abandoned when it was learned that the defendant had no means to effect any payments. It was evident that such carriage of goods should have been concluded only with true carriers, owners of the ships.

Characteristic frauds: the named vessel does not exist; incorrect name of port for cargo loading; incorrect date of cargo loading; incorrect condition of cargo and incorrect space where cargo is stowed in the vessel.

Typically the fraud involves:

- A deliberate overstatement as to the quantity of the cargo laden;
- A misdescription of the cargo laden;
- The post or ante dating of the Bill of Lading.

b. Cargo Ships

The fraud problem was recognized in Ancient Rome, where the unseaworthy ships, with non-existent cargo alleged to be wheat, were scuttled. It was expected that the state will pay for the damages. Scuttling does not represent “perils of the sea.” Illegal sinking of ships has been happening since that time onwards, when freight rates are low and when fraudsters steal goods or even ships, which in the latter case becomes the act of piracy.

Cargo owners could be endangered in case of deviation of ship (departure from contemplated course of voyage) or unauthorized change of voyage.

c. Transport Documents Issued by Freight Forwarders

The Association of Freight Forwarders (FIATA) recommends to their members to issue to their customers the FIATA FTC – Forwarders Certificate of

Transport upon the receipt of goods entrusted to them. The freight forwarder is responsible for delivering the received goods solely to the holder of this document (original). Otherwise, the freight forwarder could become responsible to pay damages. Often, freight forwarders' certificates were abused. Some freight forwarders issue their own certificates, which have no proper value, thus successfully helping fraudsters.

Cube-cutting is a fraud perpetrated by forwarding agents on their customers and shipping firms. Its rewards are magnified by the existence of shipping tariffs used by all major carriers and computed by reference to the type of cargo shipped and its cubic dimensions.

EXAMPLE:

Samsung TV sets were sold under CIF terms, payment to be effected by the letter of credit. It was stipulated that the forwarding certificate will be the document presented to the bank for collection. The goods were carried by railway from the port Z to the town Y. It was agreed that the train will not stop until it reaches the destination. The train "disappeared" and never reached its destination. After presenting the documents agreed with the bank, the seller collected the money. Then, the buyer learned that he had been defrauded. The forwarding certificate was not a proper one. In its wording, it was indicated that the forwarder is keeping the goods on behalf of the seller instead of the buyer. The buyer could not recover from the insurance company the amount insured. The buyer did not have the title on goods, in another words, he did not qualify as the assured.

d. Multimodal Transport

The multimodal transport document indicates the name of the carrier or multimodal transport operator signed by one of them. The convention covering multimodal carriage of goods was not ratified by the prescribed number of states and thus, could not come into force. For this reason, the application of FIATA FTC is recommended.

Containers are commonly used for multimodal transport of goods. The containerization of global trade has given incredible benefits to the shipping and world economy. Yet, it has also given rise to numerous opportunities for fraud. The "Trojan" container is the one that is alleged to contain a specific cargo and yet, upon the discharge of goods, it turns out that the contents are quite different.

e. Commercial Invoice

On the face of the commercial invoice the name of the seller should be indicated. Depending on the provisions of the contract for the sale of goods, other elements should be inserted. The commercial invoice, when supported by false certificates of quality of goods, was often used to deceive the buyer. The commercial invoice is issued upon the conclusion of the contract for the sale of goods. The contract for the sale of goods is governed by the United Nations Convention on Contracts for the International Sale of Goods. The proposal that the Convention should provide the “fair dealing” by the contracting parties was not endorsed.

f. Insurance Document

A document should be issued and signed by an insurance company or its authorized agent. The original insurance document must be presented to the assured. The insurance document must indicate the amount of insurance coverage and risks covered. Insurance policy is not regulated by international conventions. The International Chamber of Commerce recommends the application of English Institute Cargo Clauses. The assured claiming payment of damages is obliged to submit the original policy to the insurance company. The insurance company confirms if the claimant is the assured.

Fraud affects every type of insurance. It includes untruthful or incomplete information provided by the insurance applicant as well as the claim of the assured based on misleading or untruthful circumstances.

Insurance fraud is any act committed with the intent to fraudulently obtain payment from an insurer. With respect to goods shipped, the fraud is appearing in two forms. The seller defrauds the buyer of goods or, simultaneously, his insurance company, that the goods are insured. This deception is assisted by the carrier. For instance, the carrier issues a “clean bill of lading”, even though the goods were delivered on board the ship in evidently damaged condition. The carrier receives the guarantee from the seller that he will be reimbursed if found liable.

Average agents, appointed by an insurance company and engaged to ascertain the cause and scope of damage to the goods insured, could issue inaccurate certificates tainted with fraud. There is only a presumption that certificate data are true.

In case of cargo theft, the insurance company often suffers, for instance when cargo was dispatched C.I.F. or when cargo theft is associated with scuttling (of vessels).

6. Letter of Credit Frauds

Letters of Credit, the mostly used method of financing international trade, have become a growing concern for the entire international trading community due to letters of credit fraud. The letter of credit is an instrument which represents the "life-blood of international commerce". A documentary letter of credit represents a separate transaction and it is completely independent from any underlying contract. However, if a foul play is suspected, courts are unwilling to issue a temporary restraining order to stop the letter of credit from being honoured until the alleged fraud is investigated. This allows fraudsters to flee with the money.

Before effecting the payment of the agreed amount to the seller of goods, the bank exercises reasonable care in examining all documents (presented by the seller) stipulated in the credit, to ascertain whether or not they appear compliant with the terms and conditions of the credit. If the bank meets this obligation, it is exonerated from any liability. Banks never examine documents in detail to see if there is any deviation from the credit terms and conditions, unless such deviations are obvious. The bank has no legal obligation of any sort to investigate the commercial prudence of any transacting party entering it on whatsoever terms (the judgement of English court, *Ferguson & General Investments Ltd.*).

Documentary letter of credit frauds are: buyers defrauded, issuing banks defrauded, confirming banks defrauded and insurance companies defrauded. One of the identified problems is that the time and distance involved in marine cargo transportation make a system of payment before delivery essential. Unscrupulous persons can manipulate the system to their own advantage. Although the letter of credit system basically operates between the buyer and the seller, there are also many agents involved in the transaction.

Therefore, transactions can be not only international but multinational, entailing all inherited problems concerning investigation and jurisdiction.

7. Marine Insurance Frauds

A marine insurance contract is a contract whereby the insurer undertakes to indemnify the assured against losses incident to marine adventure. A policy of marine insurance is a contract of indemnity against all losses accruing to the subject-matter of the policy from certain perils during the adventure. Depending on the class of insurance, active participants in a fraud appear to be: sellers and buyers of goods, carriers, transporters, warehouse keepers, average agents, insurance agents and experts appointed by the court.

EXAMPLES:

The buyer bought the peeled rice in bags shipped on board MV Valentin Zolotarev from Bayuguang (China) to Burgas (Bulgaria), terms CIF by letter of credit. The sale contract stipulated that the rice should be insured under the Institute Cargo Clauses All Risks. The seller collected the money by presenting to the bank shipping documents (invoice, bill of lading and insurance policy). When the vessel arrived in Burgas, it was found that the rice was not for consumption since it was completely tainted with mould. The buyer was defrauded. The average agent of insurance company found that the rice was not contaminated by seawater. The insurance policy had the wording All Risks in accordance with institute cargo clauses /B/-1.1.82. "B" clauses cover only the perils named in the clauses and they are not All Risks "A" clauses. The buyer could not recover under the insurance policy since the rice was damaged by seawater only. The All Risks "A" clauses cover the damage due to seawater, but they were not inserted in the insurance policy.

The above cited case MV MARIZA and MYSON. The goods on board the ship (Chinese soya and maize in bulk were insured). The certificate of insurance was issued by Lloyd's agents. The goods were partly damaged (wet). The buyer of goods could not successfully claim the damage suffered because he could not prove that he had title on goods.

8. Export Credit Insurance Frauds

Export credit insurance represents a type of insurance protection which covers the losses suffered by exporters of goods shipped or services rendered in the event of non-payment. However, it is not expected that the assured (exporter) will abuse this protection. When contracting with unknown companies, he is obliged to exercise due diligence. Buyers should be scrutinized first, because in case of buyer's bankruptcy, the exporter will not be protected by insurance. A fraudulent buyer has to be a real expert to know the right moment for declaring bankruptcy. Bankruptcy legislation pertaining to natural persons provides for the offences and is intended to punish certain classes of acts which contribute to insolvency.

Export credit insurance is divided as follows: Del credere insurance in which the creditor becomes the assured; guarantee insurance (*"suretyship"*), in which the debtor becomes the assured, and fidelity insurance in which the assured places trust in a particular person.

9. Solvency Insurance Frauds

In solvency insurance, in which the assured is covered against non-payment of debt, the debt against the loss of which the assured seeks to protect himself appears to be the subject matter of insurance. The subject matter of insurance cannot be the property of the debtor. It is necessary to distinguish solvency insurance from bank guarantees, which are many. Basically, solvency insurance is the contract of indemnity, where after the occurrence of the insured event, the assured can collect the sum insured from the insurer.

10. Investment Frauds

Investment frauds are of various types. Most forms of fraudulent schemes relate to shares and debentures or tangible assets. Bogus investment schemes flourish despite protective legislation. In order to avoid risks inherent to equity securities, speculative investors have an opportunity to enter the promised land of rapid capital growth which could appear as physical assets, such as silver and gold, which is what fraudsters look forward to. At the same time, fraudsters are deceiving both the assured and his insurer.

Affinity fraud also poses a threat to investments. Affinity fraud is when one person gains the trust of others and then deceives them in some kind of financial transaction. Affinity fraud poses a danger since it undercuts the usual warnings about investment schemes promoted by strangers.

11. Cybercrime

The term "cybercrime" covers everything from sophisticated attacks on government and trade company websites to e-mails offering fake prizes. The scale of it is hard to measure - from identity theft to hacking and online abuse. The cybercrime consists of criminal acts that are committed online by using electronic communications network and information system. Additionally, cybercrime includes everything from sophisticated attacks on government websites to e-mails causing damage.

Cybercrime could be classified in the following manner:

- Crime specific to internet, such as attacks on information system;

- Online fraud and forgery, through instruments such as identity theft;
- Incitement to terrorist act and other violence.

How many businesses suffer from cybercrime, and how much it ultimately costs them are considerable unknowns. A comprehensive methodology for estimating such loss does not exist. Businesses keep quiet, worried that customers and competitors will assume they have been compromised.

Identity theft represents a serious criminal act. Frauds via e-mail messages or website to obtain personal or financial data have become customary. Often, victims were not aware that they had been defrauded. The Internet has become a dangerous weapon for fraudsters and has certainly contributed to a gross inequality in some areas of society. Sophisticated viruses will be the workhorses of 21st century spying. Computers are stuffed with data copied and beamed around the world in seconds and it is hard to know who is behind the attack.

Cyber weapons encourage economic spying. "The hack looks like a multi-headed hydra and it may only be in the early days of its development".

Computer crime is increasing and with its technological aspects represents a serious crime. Additionally, a growing concern is a misuse of information technology. Computers often serve for commitment of various acts such as frauds, embezzlement and abuse. There are also frauds by credit cards and payments over the Internet. Criminal acts are committed in various manners such as concealment without apparent connection between the perpetrator and the victim. This allows the perpetrator to escape punishment.

As far as the assureds are concerned, it appears that they are also exposed to various frauds cited above. Personal data of the assured should be protected. However, this problem should be properly resolved so as to, on the one hand, enable the insurers to meet their obligations and, on the other, protect personal data of the assured. The protection of personal data of the assured should be proportionate. Without sufficient data of the assured, insurers will not be in a position to assess the risks to be included in the insurance cover. In its regular course of business, the insurance company needs sufficient information of the assured. Otherwise, the insurers may increase the premium, since insufficient data will not help to detect a dishonest assured who is defrauding the company.

The current EU data protection laws prohibit the transfer of personal data to the countries where privacy is not properly respected. In the European Union, the response to Cybercrime was immediate. Several EU legislative actions have contributed to the fight against cybercrime, such as enacting directives, including the establishing of the European Cybercrime Centre. In this respect, the passing of the Convention on Cybercrime in 2001 was very impor-

tant. The Convention regulates the substantive criminal law in terms of illegal access, illegal interception, data interference and misuse of devices as well as computer-related offences which include the computer-related forgery and computer-related fraud.

12. Prevention of Frauds in International Trade

Before entering into a binding agreement and when dealing with unknown persons for the first time, all parties should protect themselves by being extremely careful and by making enquiries as to the standards and integrity of the persons managing companies.

Increased global competition and rising operating costs force a growing number of traders to resort to frauds in order to survive. It is important to understand common types of fraud in international trade. Fraud deterrence is based on premises that fraud is not a random occurrence. Fraud occurs where conditions are right for it to occur. Root causes should be attacked first. Fraud detection includes identification of fraud indicators. It is different from deterrence. Deterrence involves eliminating factors that may cause fraud whereas prevention involves identifying and stopping fraud. The first step to detect fraud is to identify suspicious claims. There is no universal model for fraud prevention and its deterrence.

In respect of the bill of lading, it should be necessary to take the following measures: to survey goods in the port of loading; to ascertain that the goods were loaded on the vessel; to ascertain whether the vessel has appropriate classification (seaworthiness); to survey goods in the port of discharge; to ascertain whether the goods were adequately packed. Similar measures should be taken when the goods are shipped in containers.

In respect of cargo vessels, all trading countries should consider tightening-up of transfer of ownership, transfer of flags and ship registration.

In respect of the commercial invoice issued by the seller of goods, it should be checked whether the description of goods corresponds to the terms and conditions of the contract for the sale of goods. The survey of goods should be made before they are loaded on a truck, railway wagon, etc., whatever is the agreed carriage.

In respect of insurance, it is often said that the insurance company is the last to learn that it was defrauded. Before an insurance company accepts and pays the claim, it has to ascertain: whether the claimant is the assured and whether the claim is payable (that damage to goods were caused by insured perils). Suspicious claims should be submitted to special investigation units. The insurance policy could be avoided by insurance company if claim of the assured

is attributable to fraud. Efforts should be made to halt fraud at the writing stage and not only at the claim stage. Fighting frauds at the underwriting stage should be placed in focus to discourage would-be fraudsters.

Investigation of the letter of credit frauds is often a complex undertaking. Preventive measures include: the credit assessment (particular attention should be paid to the nature and history of the customer's business, including change of ownership and management of the company, major trading partners and its trading pattern); credit lines should be approved; drastic increase in L/C balances should be closely monitored; entering into L/C transactions under unorthodox terms should be avoided and suppliers and inspection certificates should be checked (surveyors should be independent). Protection from the letter of credit fraud can be sought in the courts of law. An injunction can be obtained that prohibits the issuing bank from effecting payment under a letter of credit if the fraud is clear and obvious. The guiding principle on fraud and injunction appears to be that the courts will apply the fraud exception only if the beneficiary is aware of the fraud.

Export credit insurance is sensitive because often it is not known who is the person expected to honour the debt. For this reason, it is expected from the creditor and his insurer to establish the reliability of a future debtor. The premium is rated based on the obtained information. Credit rating of the future assured, provided by the agencies such as Standard & Poor's, should be taken into consideration.

Investments are also exposed to frauds. There is no unique model for the protection of investors. Investment protection is a broad term referring to any form of guarantee or assurance that the investment will not be lost through fraud. Lenders would surely accept to pay a higher insurance premium to compensate for the risk of loss, if contracting parties are not sufficiently known. However, this is not a proper approach. It should be necessary to monitor brokers and others and to legally prevent them from misusing investments.

Cyber-security requires a universal and urgent approach. Separate actions have already been undertaken. Many industries have set up bodies that help companies alert each other to new threats. There are proposals how to make it easier to share intelligence about digital threats. Hackers often use the same methods and thus, the obtained knowledge of their methods should be shared in order to prepare the required measures. The European Union is drafting legislation to force companies to provide full and prompt information about hacking attacks. Computer security and cyber-security problems should be tackled immediately. The more dependent on technology people become, the more risks arise.

Psychologists and sociologists will tell you that humans have a natural tendency to want to trust one another. Sadly, the trust has been degraded by “compensation culture”. Unfortunately, there are many of those who want to take advantage of that natural tendency for their own illegal personal gain. Therefore, it is necessary to exchange relevant information, mostly through national chambers of commerce, in order to identify potential frauds. In addition, cross-border cooperation is also required. It is necessary to formalise groups for fraud investigations. Many such groups already exist, such as OLAF with anti-fraud strategy, and the Insurance Fraud Bureau in the United Kingdom. It should be necessary to establish the cooperation with law enforcement agencies. To that extent, the increased use of technology to uncover frauds is indispensable. It is also important to train the staff working in trading and insurance companies as well as the police in how to detect frauds. Changing the law in this respect will be helpful but should not be understood as a magic pill, since laws can be changed much faster than legal culture.

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