

Trade-Based Money Laundering

Act Now: What You Need to Know

Money Laundering, Terrorist Financing, Proliferation Financing and Fraud in all their forms continue to be pervasive threats to the Global economy. Whilst the past few years have seen significant developments in the field of financial crime compliance and ever-increasing scrutiny from local regulators, there is still more to be done to eliminate this threat from the Middle East region.

In this paper we explore Trade-Based Money Laundering in further detail focused in particular on the December 2020 FATF publication “*Trade-Based Money Laundering, Trends and Developments*”^{*} and provide guidance to Financial Institutions and other entities on how to assess, mitigate, identify and report the financial crime threats arising from the global trade system.

Now is the time to ensure your organization has taken the steps needed to reduce exploitation by criminals and to build robust regulatory compliance.

^{*}<https://www.fatf-gafi.org/media/fatf/content/Trade-Based-Money-Laundering-Trends-and-Developments.pdf>

Highlights of the FATF Report

- Outlines the extent to which TBML remains a significant Money Laundering (ML) risk while noting the consolidation of **known TBML techniques**: such as shell companies, freight forwarders and customs brokers, over- and under- invoicing of goods and services, over- and under- shipment of goods , falsely described goods and services and Black Market Peso Exchange, as well as **newer developments**: exploitation of legitimate supply chains without collusion between importer and exporter, introduction of criminal cash into trade transactions and growth of “surrogate shopping.”
- Covers the risk of **Trade-Based Terrorism Financing (TBTF)** that have not been reviewed in previous reports.
- Emphasizes on the **cooperation needed between public and private** sector to successfully detect and prevent TBML.
- It recognizes that **money launderers may see open account trade as more attractive** because the FI has more limited oversight of the transaction vs other methods like letters of credit or documentary collection, which require customers to provide the FI with more documentation and thus are less susceptible to TBML.

Note: Open account trade does not involve the use of Trade Finance instruments (such as Letters of Credit), it is important to distinguish that an International Trade transaction can be settled through an Electronic Transfer (open account) previous agreement of the parts– Exporter and Importer, or through the use of Trade Finance Instruments; as the latter implies the presentation of numerous documents the detection of any potential suspicious activity for FIs is easier than through a traditional payment where the data and documents related to the underlying transaction are limited.



Main Implication for FIs

- **Effectiveness of the Transaction Monitoring Models.** Many FIs consider TBML as the most complex type of ML activity to detect. TBML is highly adaptive and can exploit any sector or commodity. This makes it hard for FIs to prioritize resources and translate the latest insights into business rules and compliance systems on a real time basis.
- **Cooperation amongst FIs.** TBML schemes can consist of a large number of front companies, with funds transmitted between several banks, meaning each of the involved FIs can see only a small part of the network. This fragmentation of TBML schemes makes it inevitably difficult for FIs to identify potential TBML schemes based on the analysis of the whole chain, and in many cases limits their ability to detect discrepancies in supplementary documentation and customer profiles.
- Given the limitations and challenges a FI faces to detect and mitigate TBML, building a **sufficient level of knowledge** of TBML schemes is key for any strategy to counter this form of ML.

At Grant Thornton UAE, the Financial Crime Team can support FIs by assessing the risk exposure to TBML considering the range of products and types of transactions. Identifying the risks is the first step to setting the right controls to mitigate those risks and will be the foundations to build an effective control framework that is manageable for the Compliance teams as well as supportive to the Business growth strategy.

A deep dive into the monitoring processes (either manual or automated) of trade transactions assessed against ML risk indicators will enable the FI to identify potential gaps and produce improvement plans to enhance the control framework to further mitigate any risk. Our scope for assessing an effective transaction monitoring of trade transactions is based on the holistic review of customer's activity rather than transactions in isolation.

Note: This document is intended to be a quick guidance of the Report published by FATF and Egmont Group on Trade Based Money Laundering in December 2020.

The summaries included herein are GT's own summaries of FATF's findings.

Guidance

SECTION 1 Definitions and Trade Finance activities	1.1 Trade Based Money Laundering 'TBML'	<i>"The process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illegal origin or finance their activities".</i> The primary aim of any TBML scheme is the deliberate movement of illicit proceeds through the exploitation of trade transactions. But the aim of TBML – unlike trade-related predicate offences – is not the movement of goods, but rather the movement of money, which the trade transactions facilitate.
	1.2 Trade Based Terrorist Financing 'TBTF'	Disguising the movement of value through the use of trade transactions in an attempt to finance terrorism, whether from legitimate or illegitimate sources
	1.3 Payment Processes and Level of Risk Management	The Wolfsberg Group notes approximately 80% of international trade processed by FIs is open account trading ¹ . Exporter's point of view: Most preferable way of payment CASH IN ADVANCE / LETTERS OF CREDIT Importer's point of view: Most preferable way of payment CONSIGNMENT/ OPEN ACCOUNT
	1.4 Open Account	Sale where the goods are shipped and delivered before payment is due. TBML schemes frequently involve this method because FIs have a reduced role, meaning less oversight than for the documentary collection process.
	1.5 Documentary Collections	The exporter requests payment by presenting shipping and collection documents for the traded goods to its FI. The FI then forwards these documents to the importer's FI, who then transfers the funds to the exporter's FI, who will subsequently credit those funds to the exporter.

¹ Trade Finance Principles 2019.pdf (wolfsberg-principles.com)

SECTION 2 TBML Risks and trends	2.1 Risk Based Approach to TBML	National Risk Assessments to identify vulnerability to TBML. FATF Recommendations require jurisdictions to use that insight to inform mitigating actions and drive effective co-operation across its AML/CFT system.
	2.2 Economic Sectors and Products Vulnerable	<p>Common themes conducive to TBML exploitation:</p> <ul style="list-style-type: none"> • Goods with wide pricing margins; • Goods with extended trade cycles (i.e., shipping across multiple jurisdictions); • Goods which are difficult for customs authorities to examine. <p>Gold, precious metals and minerals. The exploitation of gold and other precious metals and minerals is often a factor in TBML schemes.</p> <p>Auto parts and vehicles. Especially trade in second-hand cars or luxury vehicles.</p> <p>Agricultural products and foodstuffs. Abuse of food supply chains involving highly perishable items such as fresh fruit and vegetables. These are low-value, high-volume products that are not necessarily affected by market saturation given their perishability. They do not use any of the common TBML techniques, instead criminals exploit these legitimate supply chains to move their criminal proceeds to different jurisdictions.</p> <p>Clothing and Second-hand textiles. Low-value, high-volume products that allows for an extended supply chain, making them attractive for exploitation in TBML schemes. The extreme price variability also makes it attractive in terms of mis-description of the price.</p> <p>Portable electronics (mobile phones, laptops, etc.) Can be deliberately misrepresented and incorrectly valued.</p>

SECTION 2 TBML Risks and trends	2.3 Types of Businesses at Risk	<p>Business indicators of TBML:</p> <ul style="list-style-type: none"> • Rapid growth of newly formed companies into existing markets; • Cash intensive business and unexplained third-party payments; • Unnecessarily complicated and complex supply chains, involving multiple transshipments; • Previously established companies specialising in one sector that unexpectedly pivot into an entirely unrelated sector. • Companies simultaneously involved in more than one unrelated sector. <p>If a company meets one or more of the above risk indicators it does not mean it is being used in a TBML scheme.</p> <p>Traditional indicators are also the Shell Companies, Freight forwarders and Customs Brokers.</p>
	2.4 Common Trade Based Money Laundering Techniques	<p>Over- and under- invoicing of goods and services: The key element of this technique is the misrepresentation of the price of the goods or services, in order to transfer value.</p> <p>Over- and under- shipment of goods : This involves the misrepresentation of the quantity of goods , including ‘phantom shipments’ .</p> <p>Falsely described goods and services: This involves the misrepresentation of the quality or type of a good or service, such as the shipment of a relatively inexpensive good.</p> <p>Black Market Peso Exchange One of the drivers behind this scheme is currency restrictions, these limit the ability of legitimate companies to purchase goods from external suppliers. Due to these limitations, businesses have to rely on complicit money traders to exchange legitimate local currency for US dollars. Drug cartels use this chain to move illicit US dollars from one jurisdiction to another.</p> <p>Emerging TBML trends:</p> <ul style="list-style-type: none"> • Exploitation of legitimate supply chains, • introduction of criminal cash into trade transactions, • growth of surrogate shopping.

SECTION 2 TBML Risks and trends	2.5 Assessment of current trade- based money laundering risks	<p>Illicit cash integration. Money Value Transfer Services (MVTs) or informal mechanisms like hawala. There is a perception that the MVTs have a less developed understanding of TBML, hence they may not question why it is facilitating a business payment of a significant amount rather than the payee using a more appropriate method.</p> <p>Surrogate shopping networks. Involve individuals or networks of shoppers purchasing desired goods on behalf of wealthier individuals to circumvent customs controls or other forms of tariff restrictions.</p> <p>Infiltration of legitimate supply chains. A criminal purchases a stake in a legitimate business, which may or may not be struggling financially, and continues using its supply chain as a method of integrating illicit cash into the financial system.</p>
	2.6 TBTF	TBTF schemes can and do rely on common TBML techniques. They can also feature legitimate firms and transactions right through the supply chain, until the funds are eventually diverted to terrorist organizations.
	2.7 Services- Based Money Laundering 'SBML'	SBML is not TBML; the fundamental difference between the two is that SBML schemes rely on exploiting the trade in services or other intangibles to disguise and justify the movement of illicit proceeds. These services and sectors are identified as vulnerable to SBML: Gambling, Software providers, Financial services, Consultancy and advisory services and trademarks and similar intangible items such as intellectual property rights.
SECTION 3 Challenges to countering TBML	3.1 Lack of understanding and awareness	Some authorities still have only a basic understanding of TBML and may not be aware of the more sophisticated aspects of this crime. Criminals use this lack of knowledge to move the proceeds of crime through trade transactions.

SECTION 3 Challenges to countering TBML	3.2 Domestic co-ordination and co- operation	<p>A lack of collaboration between national authorities remains one of the largest concerns across the authorities. Main challenges are:</p> <ul style="list-style-type: none"> • Investigative authorities focus on predicate offences and de-prioritize investigations into TBML. • Difficulties with the analysis of and combining tax, trade and financial data by investigators, FIU analysts, and other relevant experts. • Transnational nature of Trade activity may imply several Jurisdictions. • Providing information in response to a request of a foreign counterpart without significant delays.
	3.3 International Cooperation	<p>Providing the appropriate international co-operation in a timely manner is crucial to the effective detection and investigation of any criminal activity that goes beyond one jurisdiction.</p>
	3.4 Investigation and prosecution	<p>As for any other type of ML, prosecuting TBML requires the need to prove that the laundered funds or assets are the proceeds of crime and that the defendant knew this.</p>
	3.5 Challenges from the private sector perspective	<ul style="list-style-type: none"> • Not standardized reporting obligations. This places the onus on FIs and DNFBPs to detect potential instances of TBML activities and appropriately advise the FIU by reporting it in a timely manner. • TBML considered as the hardest type of ML activity to detect. It is difficult for FIs to prioritize resources and translate the latest insights into the business rules and compliance systems. TBML schemes can consist of a large number of front companies, with funds transmitted between several banks, meaning each of the involved FIs can see only a small part of the network. This fragmentation of TBML schemes makes it inevitably difficult for FIs to identify potential TBML schemes based on the analysis of the whole chain, and in many cases limits their ability to detect discrepancies in supplementary documentation and customer profiles. • Verification of information provided by their customers: Information related to Ultimate Beneficial Owner may not be available making it challenging for FIs to identify potential criminal networks. • Estimating the “fair price” of a traded commodity. FIs often have only a vague description of the traded good and establishing a “fair price” can require significant resources and may be based solely on open source information.

SECTION 4 Measures and best practices to counter TMBL	4.1 Increasing understanding of TBML	Building a sufficient level of knowledge of TBML schemes should be the foundation of any strategy to counter this form of ML. Jurisdictions may use different sources of information to develop an understanding of TBML schemes across the public and private sectors such as the NRA.
	4.2 Financial intelligence collected by financial intelligence units	<p>It is crucially important that FIUs have a well-developed understanding of TBML and sufficient resources to produce the respective financial intelligence.</p> <p>FIs are in a unique position to provide valuable leads to FIUs for detecting possible TBML schemes, given their involvement in trade finance, their knowledge of customer behaviour, and their role as a financial intermediary, executing payments on behalf of the customer.</p>
	4.3 Role of customs in countering TBML	<p>The role of customs services as the sentinels for illicit trade activity places these authorities in a unique position for detecting the use of international shipments for illicit purposes.</p> <p>Customs services have in-depth knowledge and access to the international trade arena, the flows of goods, and international supply chains, documents and data and custom cargo analysis, all of which are vital for identifying and investigating TBML activities.</p>
	4.4 Interagency groups and co-ordination bodies	<p>Co-operation and co-ordination among competent authorities is a key factor in the successful detection and disruption of any ML and TF activities.</p> <ul style="list-style-type: none"> For TBML, effective collaboration between law enforcement, prosecutors, FIUs, customs services, and other authorities, as well as swift information-sharing mechanisms, is even more crucial, due to the complexity and variety of actual TBML schemes. For TBTF, having effective co-operation and information sharing with intelligence agencies is also necessary given the inherent nexus of TF related intelligence to the detection of TBTF schemes.

<p>SECTION 4</p> <p>Measures and best practices to counter TMBL</p>	<p>4.5 Public-Private Partnerships (PPPs)</p>	<p>PPPs are a way for public authorities and a selected group of private sector entities to collaborate and efficiently achieve mutual goals. In the AML/CFT context, PPPs are usually seen as a platform to share information and knowledge about existing ML/TF typologies, identify new and emerging risks, and exchange information.</p> <p>Setting up a PPP should not be seen as the goal per se, but rather as a tool to address a particular area of concern in the national AML/CFT regime or to increase the effectiveness of domestic AML/CFT measures.</p>
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What should FIs do on this regard?

- **Risk Assessment.** An accurate identification of the risks that an FI is exposed to by commercializing Trade products is crucial to design and implement mitigating controls.
- **Design and Implementation of CDD controls.** Setting an effective Customer Due Diligence processes is the foundation that will allow the FI to get to know its customers to identify any activity that differs from its nature of business.
- **Transaction Monitoring.** Reviewing customers' activity from a holistic point of view rather than isolated transactions becomes crucial when monitoring potential money laundering activity related to Trade Finance products. Does your transaction monitoring system captures suspicious activity on Trade transactions effectively?
- **Continuous Education.** Trade Finance is categorized as a complex family of products and services that require a deep understanding from Compliance Officers in order to support in the identification and mitigation of risks. We can support you by designing and deploying trainings that suit the needs of your Company.

Please contact our Forensic Experts to know more about Trade-Based Money Laundering, other issues and services.




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