Combating Trade-Based Money Laundering (TBML) in Your Institution

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Outline

• Introduction & Statistics
• Identifying TBML Typologies
• Red Flags
• Case Study: Motor Vehicle Smuggling
• Mitigating Trade-based Money Laundering Risks
• Control Measures
• Conclusions
• References
Introduction:
Criminal’s Problem: How to move illicit products without detection

Illicit product is ready for sale

How do I avoid detection and sell and pay for my product???
Introduction

- Three main methods by which criminal organisations and terrorist financiers move money for the purpose of disguising its origins
  - Financial system
  - Bulk Cash Smuggling and Cash couriers
  - Trading in goods and services.
- Trade-based money laundering is the use of otherwise legitimate trade transactions to earn, move and store proceeds of a crime.
Why Focus on TBML

- “The Impact of Switzerland’s Money Laundering Law on Capital Flows Through Abnormal Pricing in International Trade” by Dr. John Zdanowicz

- **Event Studied**

- **Time Period Studied – 1995 TO 2000**

- **Other Variables Evaluated**
  - Interest Rates: Swiss and U.S.
  - Exchange Rates: Swiss and U.S.
  - Consumer Price Index: Swiss and U.S.
  - Producer Price Index: Swiss and U.S.

### Why Focus on TBML

#### Average Monthly Outflows – Before vs. After

<table>
<thead>
<tr>
<th>Time Period</th>
<th>$ Amount</th>
<th>% of Trade Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before the Law</td>
<td>$252,863,571</td>
<td>28.93 %</td>
</tr>
<tr>
<td>After the Law</td>
<td>$628,437,709</td>
<td>57.76 %</td>
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</tbody>
</table>

Percent Increase 149 % 100 %
Why Focus on TBML

Results of Study

Other Variables had **NO** Impact on Movement of Money from Switzerland to U.S.

The only significant variable was the **NEW LAW**

Conclusion

Increased Regulation of Financial Sector Shifts Money Laundering to International Trade

POLICY IMPLICATIONS

Close the Back Door – Monitor International Trade Pricing
Why Focus on TBML

The Back Door: Abnormal Pricing

The U.S government lost more than $53 billion in tax revenues in 2001 due to artificial over-pricing and under-pricing of products entering and leaving the country.

Result of Research

The Research came up with a computer analysis that allows Financial Institutions to determine the normal weight characteristics for very product imported into the U.S, identified a normal range, compared the weight to every imported product to the range and filtered out for abnormal and suspicious transactions.

Source: “Who is watching our back door? Business Accents Magazine College of Business Administration Florida International University
Trade-based Money Laundering Increased Focus

• ICE - Establishment Of Trade Transparency Units
• FATF Trade-based Money Laundering Report – 2006
• FATF Best Practices Report – 2008
• IFSA - BAFT – Guidelines Trade Services – 2008
• Wolfsberg Group Trade Finance Principles - 2009
Regulatory Response in the U.S.A

- Federal Financial Institutions Examination Council
- Board of Governors – Federal Reserve System
- Federal Deposit Insurance Corporation
- National Credit Union Administration
- Office of Comptroller of the Currency
- Office of Thrift Supervision
Basic TBML Techniques

- Over and under invoicing for goods and services
- Over and under shipment of goods and services
- Multiple invoicing of goods and services
- Falsely described goods and services
Trade-Based Money Laundering Implications

Money Moved out of the Country

- Under-valued Exports
- Over-valued Imports

Money Moved into the Country

- Over-valued Exports
- Under-valued Imports
Impact of Trade Price Manipulation

- Under-invoiced Exports
  - Money laundering from illegal activities
  - Terrorist financing
  - Income tax avoidance/evasion
  - Capital flight
  - Avoid export surcharge
  - Conceal illegal commissions
- Over-invoiced Exports
  - Increase export subsidies
- Over-invoiced Imports
  - Money laundering from illegal activities
  - Terrorist financing
  - Income tax avoidance/evasion
  - Capital flight
  - Justify excessive high domestic prices under price control
  - Conceal illegal commissions
- Under-invoiced Imports
  - Avoid/Reduce import duties
  - Dumping at below market prices
Red Flags

- The shipment does not make economic sense
- The transaction involves the receipt of cash or other payments from third party entities that have no apparent connection with the transaction
- The transaction involves the use of repeatedly amended or frequently extended LoC
- The transaction involves the use of front or shell companies
- Customers are conducting business in high risk jurisdictions
- Customers are shipping items through high risk jurisdictions including transit through non-cooperative countries
- Customers are involved in potentially high risk activities (e.g. drugs, weapons, chemicals etc)
Red Flags

- Customers are involved in obvious over and under invoicing of goods or services
- Customers and/or issuing banks submit excessively amended LoC without reasonable justification
- Transactions are evidently designed to evade legal restrictions including evasion of necessary government licensing requirements
- Letters of credit with any of the following missing:
  - Name and address of Applicant or Beneficiary
  - Name and address of the issuing or advising banks
  - Amount and type of currency
  - Sight or time draft to be drawn
  - Expiration date
  - Description of merchandise
  - Type and numbers of documents that must accompany letter of credit
Red Flags

• An unsigned letter of credit
• Numerous inquiries by Beneficiary regarding the LoC’s issuance (a sense of urgency and/or angry complaints)
• Presentation of the LoC documents where the bank has no record of the credits existence
• LoC opened by telex when the fax has not been tested with the receiving bank
• LoC involving obscure ports and or locations that cannot be contacted by telephone or email or fax
Solution to TBML

• Generic Character-based Analysis
  – Current Policies Procedures
  – Customer Due Diligence
  – Know Your Customer
  – OFAC Lists
  – PEP Lists
  – Corruption Index List
  – PRODUCT Risk Index
  – Training
  – Obtain a method for checking precious metals

• Transaction Based Analysis –evaluation of prices

• Country Risk Analysis
  – Country Risk Index

• Documentary Analysis
Conclusion

• As International trade increases TBML can be expected to become increasingly active.
• Basic Schemes: Fraudulent trade practices such as over and under invoicing will increase
• Trade-based money laundering is an important money laundering technique that has received limited attention from policymakers in Africa.
• Building better awareness, strengthening measures to identify trade-based illicit activity and improving inter agency and international co-operation and provide Trade data is a way out.
References

- John S. Zdanowicz, Ph.D.

Florida International Bankers Association
Professor of Finance
Florida International University
john.zdanowicz@fiu.edu

President – International Trade Alert, Inc.
johnz@internationaltradealert.com

- www.italinternationaltradealert.com
- The impact of Switzerland's money laundering law on capital flows through abnormal pricing in international trade
  - Maria de Boyrie
  - Simon Pak
  - John S. Zdanowicz, Ph.D.
Questions & Issues
Thank You

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Trade finance ML

10 December 2013

Solomon Kofi Dawson
Head, Compliance & AMLRO
uniBank Ghana
Introduction

- The Trade Finance Principles sets out the background to trade finance and addresses the AML/CTF/Sanctions risks. Its also comments on the application of controls in general and makes some observations on the subject of future co-operation between relevant stakeholders.

-Wolfsberg group
Controls in trade finance

- Due diligence
- Reviewing
- Screening
- Monitoring
Due diligence

• This is used here to describe both the process for identifying and knowing the customer but also for risk based checks in relation to parties who may not be customers. Given the range of meanings applied reference will be made as necessary to “appropriate due diligence”, which may consist of risk based checks only.
Reviewing

• This is defined here as any process (often not automated) to review relevant information in a transaction relating to the relevant parties involved, documentation presented and instructions received.

• As will also be described under the Risk Indicators section certain information can and should be reviewed and checked before transactions are allowed to proceed.
Screening

- This is usually an automated process to compare information against reference sources such as terrorist lists. Screening is normally undertaken at the same time as reviewing and prior to the completion of the specific activity subject to review. It may also be undertaken at the same time as, or as part of, due diligence.
Monitoring

- Any activity to review completed or in progress transactions for the presence of unusual and potentially suspicious features. For trade transactions it should be recognised that it is impossible to introduce any standard patterning techniques in relation to account/transactional monitoring processes or systems. This is due to the range of variations which are present even in normal trading patterns.
Simplified scenario

• Party X is selling goods to Party Y. Party X is willing to ship the goods but does not want the documents which entitle Party Y to receive the goods to be released until Party Y has paid for them or given specified payment undertakings.

• In this scenario it is assumed that Party X is the customer of Bank A and Party Y is the customer of Bank B.

• Party X (the seller) instructs Bank A to collect payment in relation to documents drawn on Party Y (the buyer). Bank A selects (its correspondent bank or Party Y’s nominated bank) Bank B to present documents for payment to Party Y locally in the other country.
Simplified scenario, cont’

• The delivery of documents to Party Y by Bank B is typically conditioned on:
  • Payment (authorization to debit their account) by Party Y to Bank B, or
  • Acceptance/Issuance by Party Y of a financial document (drafts, promissory notes, cheques or other similar instruments used for obtaining money) agreeing to pay Party X at a specified future date or
  • Other stipulated terms and conditions
Simplified scenario, cont’

• The presentation terms (collection instruction) are determined by Party X and conveyed to Bank A, who in turn, provides the collection instruction to Bank B at the time of presentation of documents for collection. Unless otherwise specifically agreed, neither bank incurs any liability to make payment.
Simplified scenario, cont’

• This guidance/appendix will describe various controls which could or may be applied by FIs in the context of the collection.

• Party X >> Bank A >> Bank B >> Party Y
• Drawer (Remitting bank) Collecting bank Drawee
• Principal Presenting bank Buyer
  Exporter
  seller
  Importer
Due Diligence Overview

- The banks will conduct due diligence which will normally follow the pattern described below
- Bank A will conduct due diligence on Party X
- Bank A may conduct appropriate due diligence on Bank B
- Bank B may conduct appropriate due diligence on Bank A
- Bank B will conduct due diligence on Y
Party X (seller)

Bank A

Party Y (Buyer)

Bank B
Reviewing activity overview

• Once the BC is initiated the banks will then review the transaction in accordance with standard banking practice at various stages through to the eventual payment being made. This reviewing activity will normally follow the pattern described below

• Bank A will review the collection instruction from X
• Bank B will review the collection instruction received from Bank A
• Bank A and Bank B will review the payment (or other) instructions received.
Controls undertaken by Bank A

- Party X Due diligence
- Bank A should conduct appropriate due diligence (Identification, verification screening & KYC) on Party X (who is a Customer of Bank A) prior to acceptance and execution of the original instruction. This is likely to involve a series of standardized procedures for account opening within Bank A.
- As the handling of BCs involves no direct financial responsibility for Bank A and does not involve Bank A necessarily in any lending to Party X the normal due diligence for opening an account will generally apply.
Enhanced Due Diligence

- An enhanced due diligence process should be automatically applied where party X falls into a higher risk category or where the nature of their trade as disclosed during the standard due diligence process suggests that enhanced due diligence would be prudent. The enhanced due diligence should be designed to understand the trade cycle and may involve establishing:
  - The countries where Party X trades
  - The goods traded
  - The type and nature of principal parties with whom Party X does business.
Enhanced Due Diligence, cont’

- The nature of business and the anticipated transactions as described and disclosed in the initial due diligence stage may not necessarily suggest a higher risk category but if this becomes apparent after transactions commence this may warrant additional due diligence.
Bank B - Due Diligence

• Bank A should undertake appropriate due diligence on Bank B. The due diligence may support an ongoing relationship with Bank B which will be subject to a relevant risk-based review cycle. Due diligence on Bank B is not therefore required in relation to each subsequent transaction.

• In other circumstances Bank B may neither have nor need to have a relationship with Bank A. Bank A will need to decide when sending the BC to Bank B whether it should undertake any checks in relation to Bank B or whether it should route the collection through another intermediate Bank with whom a relationship already exists.
Reviewing

• The level of reviewing activity may be limited to that described as standard below.

Standard

• Appropriate reviewing may be conducted by Bank A in relation to the BC instruction received from Party X which may take account of the following.
  • Sanctions & terrorist lists which may affect
  • Any principal party as named target
  • The country in which Bank B and Party Y is located
  • The goods involved
Reviewing, Cont’

- Enhanced
- Enhanced reviewing is likely to be applied only to transactions where there is a particular reason for closer examination or scrutiny, and which may then take account of the following:
  - The countries which are rated as high risk for other reasons, as related to:
  - The countries where Bank B or Party Y are located
  - Transit countries through which the goods will be shipped (only if visible on the collection instruction)
  - The goods described in the transaction to ensure that the nature of these goods does not appear inconsistent with what is known of Party X
Reviewing, Cont’

Depending on the information arising from this screening process Bank A may need to;

• Make further internal enquires as to the appropriate course of action
• Request more information from Party X before agreeing to proceed with the transaction
• Allow the transaction to proceed but make a record of the circumstances for review purposes
• Decline the transaction if enquiries do not provide reasonable explanations, and subject to circumstances and local legal requirements submit a suspicious activity report
Monitoring

• For Bank B the monitoring opportunities arise from
• The normal procedures for monitoring the account and payment activity of Party Y.
• Patterns of activity observed from business as usual trade processing more generally
Limitations faced by bank A

- Bank B is not the originator of the transaction but is requested to act on instructions received by Bank A (although it is not obliged to do so).
- In accordance with established practice for handling BCs, Bank B will have limited time in which to act upon such instructions.
- In handling the BC Bank B’s role for the due diligence on Party X is limited to reviewing of Party X’s name against sanctions and terrorist lists.
Risk Indicators - Pre and Post Event

• Since the full execution of each BC transaction is a fragmented process involving a number of parties, each with varying degrees of information about the transaction, it is extremely rare for any one Bank to have the opportunity to review an overall trade financing process in complete detail given the premise of the trade business that banks deal only in documents. Furthermore it is relevant to note that

• Different Banks have varying degrees of systems capabilities which will lead to industry wide differences in their reviewing abilities

• Commercial practices and industry standards determine finite timescales in which to act.
Risk Indicators - Pre and Post Event

• In determining whether transactions are suspicious due to over or under invoicing (or any other circumstances where there is misrepresentation of value) it needs to be understood that Banks are not required to check the underlying documents presented with BCs.
Risk Indicators - Pre and Post Event

- it is important to distinguish between
  1. Information which must be validated before transactions are allowed to proceed or complete and which may prevent such completion (e.g. a terrorist name, UN sanctioned entity).
  2. Information which ought to be used in post event analysis as part of the investigation and suspicious activity reporting process.
<table>
<thead>
<tr>
<th>S/N</th>
<th>Activity or information connected with the BC</th>
<th>WHEN</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Goods • Applicable export or import controls may not be complied with</td>
<td>PRE</td>
</tr>
<tr>
<td>2</td>
<td>Goods • Manifest anomalies value ≠ quantity (to the extent reviewed and to the extent apparent) • Manifestly out of line with customers known business</td>
<td>PRE OR POST</td>
</tr>
<tr>
<td>3</td>
<td>Countries/principal parties • On the Sanctions/terrorist list</td>
<td>PRE</td>
</tr>
<tr>
<td>4</td>
<td>Countries • On the Bank’s high risk list • Any attempt to disguise/circumvent countries involved in the actual trade</td>
<td>PRE OR POST</td>
</tr>
<tr>
<td>5</td>
<td>Payment instructions • Illogical • Last minute changes</td>
<td>PRE OR POST</td>
</tr>
<tr>
<td>6</td>
<td>Repayment arrangements • Third parties are funding or part funding the collection</td>
<td>PRE OR POST</td>
</tr>
<tr>
<td>7</td>
<td>Counterparties • Connected drawer/drawee, where obvious</td>
<td>PRE OR POST</td>
</tr>
<tr>
<td>8</td>
<td>Anomalies in instructions • Unexplained third parties • Absence of transport documents</td>
<td>PRE OR POST</td>
</tr>
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</table>
THANK YOU

A word to a wise is enough
Investigating Criminal Activity in Motor Vehicle Smuggling and possible links to other crimes, including terrorist financing…

Bahlakoana Shelile

Economic Intellect Consulting
Lesotho
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1. Background

2. Money laundering vulnerabilities related to illicit trade in and smuggling of motor vehicles

3. Some offences related to illicit trade in and smuggling of motor vehicles

4. Case Study – motor vehicle identity theft (cloning)

5. Some possible steps in motor vehicle anti – smuggling initiatives
Background

- The illicit trade in and smuggling of motor vehicles in nature are both multi jurisdiction and multi industries criminal activities.
- While trends in illicit trade in and smuggling of motor vehicles have always been transforming, they seem to be leaning more towards "value for money".
ML vulnerabilities related motor vehicle smuggling

- Unregulated Motor Vehicle Industry
- Cash based nature of transactions
- Ineffective controls on bonded warehouses
- Insufficient cooperation with the vehicle manufacturers
- Ineffective exchange of information amongst local and regional LEAs
Some Offences related to MV smuggling

- False declaration/misclassification
- False registration
- Theft of motor vehicles
- Use of fraudulent documents
- Illegal chop shops
- Cloning
Case study - cloning

- December 2008, a red Toyota Venture was stopped at the road block between Durban, RSA and Swaziland by SAPS.
- Earlier, a Swazi family man purchased a brand new red Toyota Venture from a Toyota dealership in Swaziland.
- Motor vehicles criminal syndicate goes window shopping for vehicle identity information.
- The Swaziland red Toyota Venture vehicle identification information is stolen...
Case study – cloning…

- **Investigation findings**
  - The criminal syndicate operated both in RSA and Swaziland
  - Both red Toyota Ventures were purchased through a bank finance facility
  - Both red Toyota Ventures were purchased from licensed authorised dealerships
  - The syndicate, non Swazi Nationals had a front company in Swaziland and property acquired using proceeds of illicit trade
Motor Vehicle – Anti Smuggling Initiatives

1. Increased information sharing among the regional LEAs, (SARPCCO & EAPCO) – Preventative approach…

Thank you...
Control Measures To Deal With Trade-based Money Laundering

Reindorf Atta Gyamena,
CAMS, Head of Compliance Unit, CAL Bank Ghana
To develop your TBML controls you must have:

- Done your Risk Assessment to determine how your institution is exposed to TBML.
- Determined some of the methodologies.
- Know that Tax evasion is the dominant predicate offence for TBML.
1. Colombian drug cartel smuggles illegal drugs into the United States and sells them for cash.

2. The drug cartel arranges to sell the US dollars at a discount to a peso broker for Colombian pesos.

3. The peso broker pays the drug cartel with pesos from his bank account in Colombia which eliminates the drug cartel from any further involvement in the arrangement.

4. The peso broker structures or smurfs the US currency into the US banking system to avoid reporting requirements and consolidates this money in his US bank account.
BLACK MARKET PESO EXCHANGE ARRANGEMENTS

5. The peso broker identifies a Colombian importer that needs US dollars to purchase goods from a US exporter.

6. The peso broker arranges to pay the US exporter on behalf of the Colombian importer from his US bank account.

7. The US exporter ships the goods to Colombia.

8. The Colombian importer sells the goods, often high-value items such as personal computers, consumer electronics and household appliances, for pesos and repays the peso broker. This replenishes the peso brokers supply of pesos.
Drug cartels sell drugs smuggled into the US for cash

1. Peso broker pays drug cartels from his peso account

2. Drug cartels sell dollars to peso broker

3. Peso broker pays drug cartels from his peso account

4. Smurfs deposit drug dollars into US banks

5. Peso Broker

6. Peso broker pays US exporters on behalf of Colombian importers

7. US exporters ships goods to Colombian importers

8. Colombian importer pays peso broker

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3rd Annual AML & Financial Crime Conference, Africa
<table>
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<th><strong>CONTROLS TO DEAL WITH TRADE BASED MONEY LAUNDERING</strong></th>
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<td>Staff focused training is important for all the controls to be effective.</td>
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Thank You!