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International Banking

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Trade-Based Money Laundering

Many international banks headquartered outside the United States that maintain branches or subsidiaries in the United States often focus on financing trade transactions for companies based in the bank's home country.

These branches and subsidiaries provide a service critical for an international company that seeks to offers its products in the U.S. market. For many years, the imports of products to the United States have exceeded exports from the United States.[1]

Unfortunately, trade financing also has been abused by criminals to launder the proceeds of their crimes. While perhaps not publicized as much as other methods of money laundering, money laundering through trade financing is an issue that needs to be monitored by banks that finance international trade transactions.

This month's column will discuss a "Best Practices" Paper issued recently by the Financial Action Task Force (FATF), the international intergovernmental body that develops and promotes policies to combat money laundering and terrorist financing.

Some Background

The "Best Practices Paper on Trade-Based Money Laundering" issued at the end of June,[2] follows up on a 2006 FATF paper on trade-based money laundering.[3]

In its reports, the FATF notes that abuse of the trade system by criminals is one of the main methods of moving funds derived from illegal activity. And, as increased regulation upon other businesses (such as money services businesses) has become more effective at lessening the dangers of money laundering through those businesses, the FATF sees trade financing as becoming an even more attractive means of money laundering.

How is trade finance used to facilitate money laundering? Methods used include over- and under-invoicing of goods and services, double invoicing of goods and services, over- and under-shipments of goods, false descriptions of the goods that are the subject of the trade finance transaction, use of front companies, and the use of products to conceal cash in bulk so it could get across the border without being declared or detected.

The Importance of Training

It also is important that legitimate trade transactions not be disrupted. The Best Practices paper urges training of both governmental authorities and bankers on recognizing trade-based money laundering.

For the governmental authorities, training could include a focus on the existence and relevance of financial and trade data to crime targeting, and techniques for conducting such analysis.[4] Examples of these techniques included the following:

- Comparing import/export data to detect discrepancies in countries of origin, brokers, prices, places of entry and exit for the products, and any seasonal flows for the products in question;
- Comparing export information with tax declarations to detect discrepancies;
- Utilizing information supplied by a country's Financial Intelligence Unit (such as the U.S. Financial Crimes Enforcement Network) to identify patterns of deposits, imports and exports of currency, as well as reports of suspicious financial activities and the parties identified therein.

The Best Practices paper also encourages appropriate training of banking supervisors on how to best evaluate the adequacy of a bank's policies, procedures and processes for handling trade financing, such as adequate recognition by the bank of the risks involved with these types of transactions and awareness of red flags for suspicious activities in this area. The supervisors also should examine the adequacy of the training programs by the bank for its trade unit employees, based in the United States, in the home country and elsewhere around the world.

Utilizing Public Supervisory Information

In the U.S. bank regulators' "Bank Secrecy Act/Anti-Money Laundering Examination Manual,"[5] there is a specific section on trade finance. This section provides a description of all the various roles that could be played by a bank in a trade finance situation (such as an issuing, confirming or paying bank on a letter of credit) and emphasizes risk mitigation through use of a thorough customer due diligence process, an insistence upon reliable documentation and a better understanding of the "red flags" that could arise in trade transactions. These red flags include business being conducted from jurisdictions at high risk for money laundering, unnecessarily complex transaction structures and inconsistencies regarding products, pricing and parties among the documents submitted to the bank for review.

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Cooperation Domestically, Internationally

In the United States, governmental agencies focusing on customs and U.S. trade issues (e.g., the departments of Homeland Security and Commerce) differ from those focusing on combating money laundering (e.g., the departments of Treasury and Justice). The Best Practices paper noted that most countries would benefit from more-effective information sharing among the relevant governmental agencies and, as a result, recommends that countries develop a mechanism for linkage of all the agencies collecting, analyzing and storing trade data with anti-money-laundering authorities.

Examples provided include execution of interagency memoranda of understanding, formation of multi-agency task forces and development of what the report calls a "Trade Transparency Unit," where the staff have experience in conducting both anti-money-laundering and trade fraud investigations, and have access to information from all the relevant trade and law enforcement agencies.

Similarly, the Best Practices paper encourages increased cooperation at the international level, including mutual legal assistance in cross-border investigations and prosecutions and enhanced sharing of trade information. Collection and dissemination of data must be in compliance with all applicable privacy and data protection laws. This can be difficult at times given the wide range of these laws that exist. However, excluding information about specific trade transactions (such as counterparties) likely will expand the amount of data that can be shared with counterparts in other countries.

What Should Banks Look For?

Taking all of the above into account, what are some practical steps that can be taken by international banks (both within and outside the United States) to protect themselves?

• ***Really know the customer.*** In addition to the usual customer identification procedure that is required to be in place at U.S. banks, including U.S. offices of non-U.S. banks, consider whether the bank should institute enhanced due diligence on the customer and the transactions it seeks to conduct through the bank. It can be even more critical in these situations to obtain more detailed information on the owners of the company, the history of the company, and the company's other sources of income and credit. Even if the customer of the U.S. office of the international bank already may be a customer of the bank in another country (such as the bank's home country), that fact alone is insufficient for the U.S. office of the bank; it also must do its own due diligence on the customer.

• ***Know the customer's business.*** In addition to knowing the customer, develop an understanding of the customer's business. What are the common markets for these products? Is it a product for which there is a need in the United States? A customer seeking trade financing for a product for which there is little or no market in the United States should be a red flag to the bank to conduct a more in-depth analysis of the customer and the proposed transaction.

Trade financing has been abused by criminals to launder proceeds of crimes. While perhaps not publicized as much as other methods, money laundering through trade financing needs to be monitored by banks that finance international trade transactions.

• ***Know the usual method of doing business for the particular product offered by the customer.*** There are different ways to offer financing for a trade transaction. The bank should check to see if the method of financing requested is the market method of financing trade transactions for the product being sold or bought by the customer. If not, then this also should be a red flag to the bank to investigate the transaction in more depth. Methods also can include methods of shipment; for example, is it usual to ship the particular product in the method proposed? If not, then perhaps the bank should inquire further.

• ***Know generally the usual market price for this product.*** The bank should have a general knowledge of the market for the product. If the usual price of a particular product is $500 per ton and the customer is seeking financing to import or export the product at a rate of $2,500 per ton, and there appears to be no objective reason for such an increase (for example, there is not a worldwide shortage of the particular product that might cause an upward spike in price), then that should be a red flag to the bank to investigate the transaction further.

A customer engaged in legitimate trade transactions will be able to provide the information needed by the bank to evaluate the company, its products, its pricing schedule and the general market for the products. Also, the Internet or commercial data bases can be utilized by the bank to confirm the information provided by the customer and to build up an independently obtained file of data on the products in question.

What Can Regulators Do?

More coordination among regulators, utilization of information already collected and cross-training of trade and law enforcement government employees are necessary to expand the knowledge base of the affected employees. Those employees in turn may be able to provide more useful guidance to the banking community on fighting trade-based money laundering.

Conclusion

While a desire to assist their home country businesses is logical, international banks need to keep in mind that international trade financing can be an easy way to launder money. However, by focusing on knowing the customer as well as the customer's business, and the usual methods by which the customer conducts its business, an international bank will have a sharpened ability at being able to determine when it is being misused as part of a trade-based money laundering scheme.

1. See the list of Foreign Trade Statistics on the Web site of the U.S. Commerce Department's U.S. Census Bureau at http://www.census.gov/foreign-trade/balance/c0004.html#2008.
2. "Best Practices Paper on Trade Based Money Laundering," June 20, 2008, is available on the FATF's Web site at http://www.fatf-gafi.org/dataoecd/9/28/40936081.pdf.
3. "Trade-Based Money Laundering," June 23, 2006, is available on the FATF's Web site at http://www.fatf-gafi.org/dataoecd/60/25/37038272.pdf.
4. Best Practices Report, page 3.
5. The most recent version of the manual (2007) may be found at http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2007.pdf.