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Introduction to Trade-Based Money Laundering and Sanctions Compliance

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Topics to be Covered

I. What is Money Laundering + case study

II. Trade-Based Money Laundering

III. Terrorist Financing

IV. Sanctions

V. International Standards

Image credit: State of California Department of Justice

I. AML: What is Money Laundering

➢ **Money laundering is the process of taking money obtained from illegal activities and making it appear legitimate.**

- Examples of criminal activities include:
  - drugs trafficking
  - arms smuggling
  - fraud
  - tax evasion

I. AML: What is Money Laundering

Stages of Money Laundering:

Placement:

- Introducing cash into the financial system by some means, such as:
  - Multiple cash deposits
  - Checks
  - Investment products, insurance, etc.

Layering:

- Separating proceeds of criminal activity from their origin
- Hiding or confusing the audit trail
- Buying and then selling investment product
- Wiring payments to and from various accounts in different jurisdictions
- International trade transactions

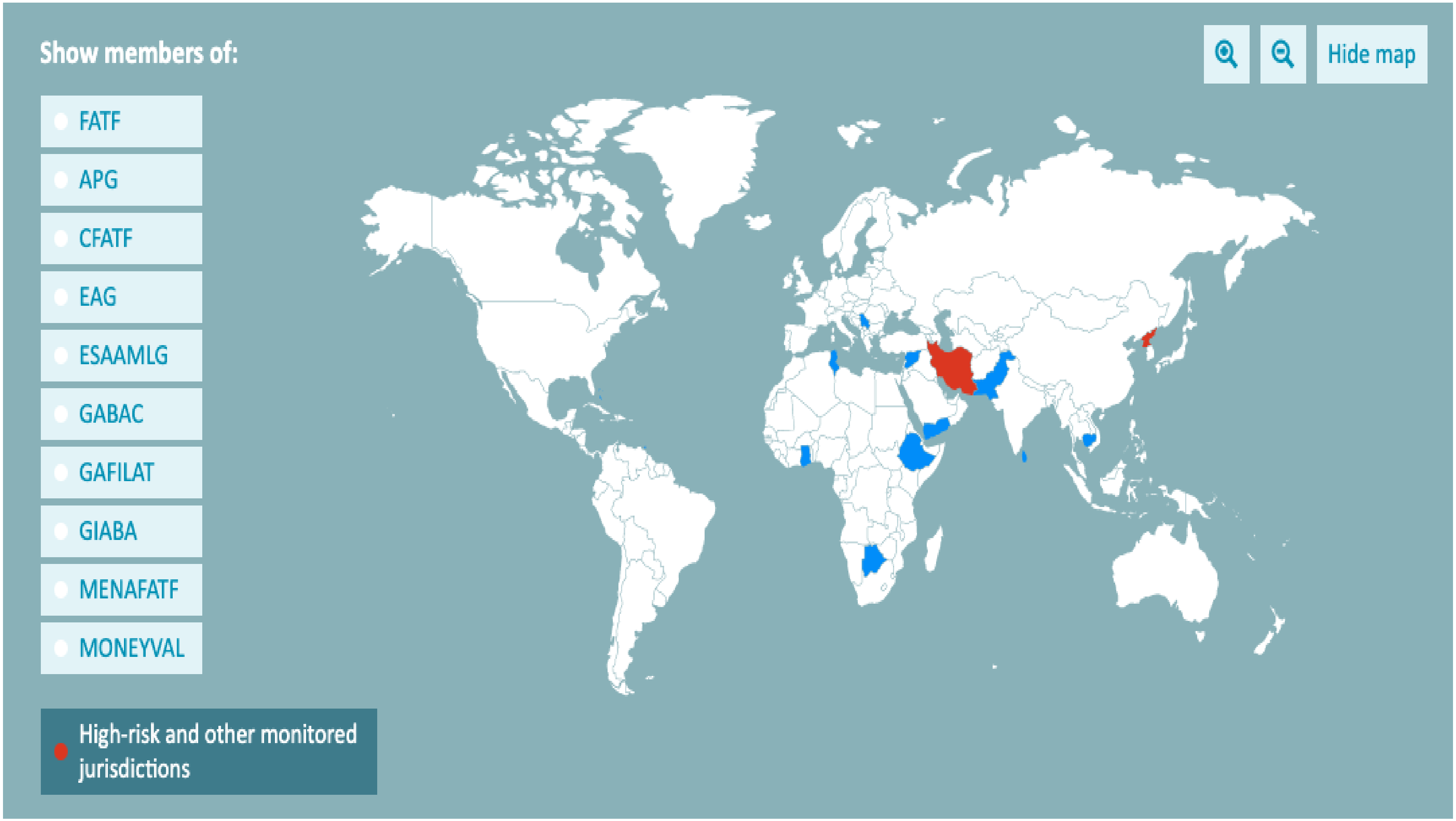
Integration:

- Money appears legitimate
- Used to purchase property, high value items
- Investments in businesses

I. AML: What is Money Laundering

- **High risk jurisdictions include countries in which:**
  - Production or transportation of illegal drugs take place
  - Large volume or value of trade exists
  - High incidence of corruption
  - High level of organized crime
  - Relaxed regulatory environment
  - Bank secrecy havens

I. AML: What is Money Laundering



I. AML: What is Money Laundering

➢ **Money laundering risk areas for banks include but are not limited to:**

- Lending
- **Trade finance**
- Wire transfer
- Foreign exchange
- Private banking
- Correspondent banking
- Insurance
- Real estate
- Internet banking

I. AML: Small Group Case Study

Case Study: Loan Repayment before Term

Mr. Abbasov has UZS 75 billion in money from selling heroin. He approaches his bank for a 10-year construction plus term loan to build a small apartment complex in Tashkent. Having shown sufficient assets and working with a reputable contractor, he obtains a loan for UZS 50 billion and provides UZS 25 billion of his own equity.

After six months, he repays the loan before its term with his remaining 50 billion in drug money. He then waits two months and requests a 20 billion loan to be paid over five years with rents collected from the tenants.

He has thus laundered his dirty money and can easily make the loan payments, continuing to profit off investment rents.

How could the bank have identified this?

I. AML: Small Group Case Study

Case Study: Business set up to launder money

Ms. Ivanova approaches the bank for a car loan to buy a 2019 Mercedes Benz sedan. She owns an exclusive high-end restaurant although it is in a bad neighborhood in Tashkent. The loan officer reviews the restaurant's tax returns, and it shows large profits every year.

What additional due diligence should the loan officer perform in this situation?

II. AML: Trade-Based Money Laundering

- Trade based money laundering is the process of disguising the proceeds of crime by moving value through the use of trade transactions in an attempt to legitimize their illicit origins.
  - Trade based money laundering provides criminals an easy way to move illegal money
  - Collusion between buyer and seller
  - Trade price manipulation
  - Short or over shipping
  - 'Phantom shipping' where documentation is falsified and there is no shipment of goods

Sources: ACFCS Presentation (October 16, 2013) and Financial Conduct Authority, *Banks' control of financial risks in trade finance* (July 2013)

II. AML: Trade-Based Money Laundering

Open Account Trading vs. Financing of Trade:

Wire transfers provide:

- Originator's name
- Beneficiary's name
- Amount
- Value date

Letters of Credit provide:

- Importer of record
- Exporter of record
- Amount
- Value date
- Description of goods or commodities
- Shipping details including title document
- Miscellaneous such as customs related documents

Sources: ACAMS Presentation October 22, 2015 on Trade-Based Money Laundering

II. AML: Trade-Based Money Laundering

- **Black Market Peso Exchange (BMPE) is the process by which:**
  1. Colombian drug cartel sells drugs in the U.S. for dollars
  2. The dollars are laundered by peso brokers and deposited into U.S. banks
  3. The dollars are then used to purchase goods
  4. The goods are exported to Colombia and sold for pesos.

This can be done in any currency.

II. AML: Trade-Based Money Laundering

➢ Example: BMPE

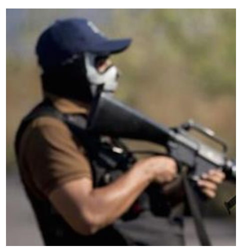
- In September 2014, a law enforcement operation called Operation Fashion Police carried out a search of 50 small businesses in the Los Angeles Fashion District
- Mexican drug cartels were using fashion-related businesses for money laundering activities under a BMPE scheme
- Drug sales in the U.S. were used to purchase clothing in USD
- Clothing shipped to Mexico and sold and paid for in Mexican pesos
- Equivalent amount of drug proceeds (minus a commission) was paid to the drug cartel in pesos
- 9 people arrested and USD 90 million was seized

II. AML: Trade-Based Money Laundering

➢ Example: Under invoicing – selling something for nothing

- Move USD 1 million from U.S. drug dealer to Colombian drug supplier through U.S. export at low price

USD 1 million → Colombian supplier

1.  200 Rolex watches at USD 5,000 each
2.  Export →  at USD 5 each
3. Colombian supplier sells 200 Rolex watches at USD 5,000 each (USD 1 million)

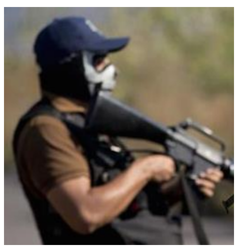
Source: ComplyArena, *The Impact on Exporters of Foreign Assets Control, Anti-Boycott, and Anti-Money Laundering Regulations*

II. AML: Trade-Based Money Laundering

➢ Example: Over invoicing – buying nothing for something

- Move USD 1 million from U.S. drug dealer to Colombian drug supplier through U.S. import at high price

USD 1 million → foreign supplier

1.  10,000  at 10 cents each (USD 1,000) locally

2. Foreign drug supplier sells 10,000  at USD 100 each

3. US drug dealer pays USD 1 Million to Columbian supplier

Source: ComplyArena, *The Impact on Exporters of Foreign Assets Control, Anti-Boycott, and Anti-Money Laundering Regulations*

II. AML: Trade-Based Money Laundering

True Examples of Abnormal U.S. Trade Prices

- High U.S. Import Prices
  - Plastic buckets from Czech, $972/unit
  - Briefs and panties from Hungary, $739/doz
  - Cotton dishtowels from Pakistan, $153/unit
  - Ceramic tiles from Italy, $4,480/sq meter
  - Metal tweezers from Japan, $4,896/unit
  - Razors from the U.K., $113/unit
  - Camshafts from Saudi Arabia, $15,200/unit
  - Iron bolts from France, $3,067/kg
  - Toilet tissue from China, $4,121/kg
- Low U.S. Export Prices
  - Live cattle to Mexico, $20.65/unit
  - Radial truck tires to U.K., $11.74/unit
  - Toilet bowls to Hong Kong, $1.75/unit
  - Bulldozers to Colombia, $1,741/unit
  - Color video monitors to Pakistan, $21.90/unit
  - Missile launchers to Israel, $52.03/unit
  - Prefabricated buildings to Trinidad, $1.20/unit

Presentation by John A. Cassara

Source: Government of the Isle of Man

II. AML: Trade-Based Money Laundering

➢ Knowing what is involved in the trade transaction:

- Goods involved in each transaction
- End use
- End user (i.e. the beneficiary of the LC)
- Verify if license is required
- Are the companies in the transaction related (group companies)?
- Is the transaction consistent with regular business activities?
- Is the transaction structure overly complex or unusual?
- Are high-risk countries involved?
- Is the price consistent with the market?
- Are there abnormalities in the trade documents?

Source: Financial Conduct Authority, *Banks' control of financial risks in trade finance* (July 2013)

II. AML: Trade-Based Money Laundering

Trade Finance Customer Red Flags:

- The customer engages in transactions that are inconsistent with the customer's business strategy or profile
- A customer deviates significantly from its historical pattern of trade activity
- Transacting parties appear to be affiliated, conduct business out of a residential address, or provide only a registered agent's address
- Customer that conducts business in jurisdictions that are at higher risk for money laundering, terrorist financing, or other financial crimes

Source: ComplyArena, *The Impact on Exporters of Foreign Assets Control*, *Anti-Boycott*, *and Anti-Money Laundering Regulations*

II. AML: Trade-Based Money Laundering

➢ Document Red Flags:

- Shipment locations of goods, shipping terms, or descriptions of goods are inconsistent with LC
- Changes in shipment locations to high risk countries or changes in quality of goods shipped
- Significant discrepancies between descriptions of goods on bill of lading and actual goods shipped
- Beneficiary or applicant refuses to provide documents to prove shipment of goods
  (possible phantom shipping or multiple invoicing)

Source: Financial Conduct Authority, *Banks' control of financial risks in trade finance* (July 2013)

Transaction Red Flags:

- Unnecessarily complex transaction structure designed to hide the true nature of the transaction
- Transaction is an offshore shipment
- Involves an unusual intermediary or number of intermediaries
- Significantly amended LC without reasonable justification
- Changes to beneficiary or payment location
- LC contains non-standard clauses or has unusual characteristics
- A party to a transaction is a shell company

Source: Financial Conduct Authority, *Banks' control of financial risks in trade finance* (July 2013)

Payment Red Flags:

- Obvious over — or underpricing of goods
- Unexplained changes to payment instructions
- Request to pay a 3rd party
- The payment terms or tenor are inconsistent with the type of goods

Source: Financial Conduct Authority, *Banks' control of financial risks in trade finance* (July 2013)

II. AML: Trade-Based Money Laundering

Shipment Red Flags:

- Quantity of goods exceeds the known capacity of the shipping container or tanker or suspicious abnormal weights for goods
- Shipping documents show weights and measures inconsistent with goods shipped
or method of shipment

Source: Financial Conduct Authority, *Banks' control of financial risks in trade finance* (July 2013)

III. AML: Terrorist Financing

- **Terrorist financing** is the provision or collection of funds to carry out an act of killing or seriously injuring civilians or destroying infrastructure with the objective of intimidating a government or population.
  - Funding of terrorist activities may involve legitimate sources of funding
  - Terrorists launder money to protect the identity of their sponsors and ultimate beneficiaries of the funds
  - Financial transactions associated with terrorist financing tend to be in smaller amounts than money laundering
  - Terrorists use a variety of methods to move money within and between organizations
  - Dual-use goods

Source: FINTRAC

IV. AML: Sanctions

- **Sanctions** is the action by one or more countries toward another country, group of individuals, entities or specific sectors to force the sanctioned party to comply with legal obligations or international norms.
  - The U.N. Security Council imposes sanctions to enforce international law, but depends on member nations to actually enforce them
  - The U.S. often takes independent action, usually before the U.N.
  - Sanctions can be either comprehensive or they may be selective
  - Sanctions include travel bans, asset freezes, arms embargoes, capital restraints, foreign aid reductions and trade restrictions
  - Most widely used sanction lists are: UN Security Council, EU, OFAC and UKHMT

IV. AML: Sanctions

Major Sanctions Violations Cases 2009—2019

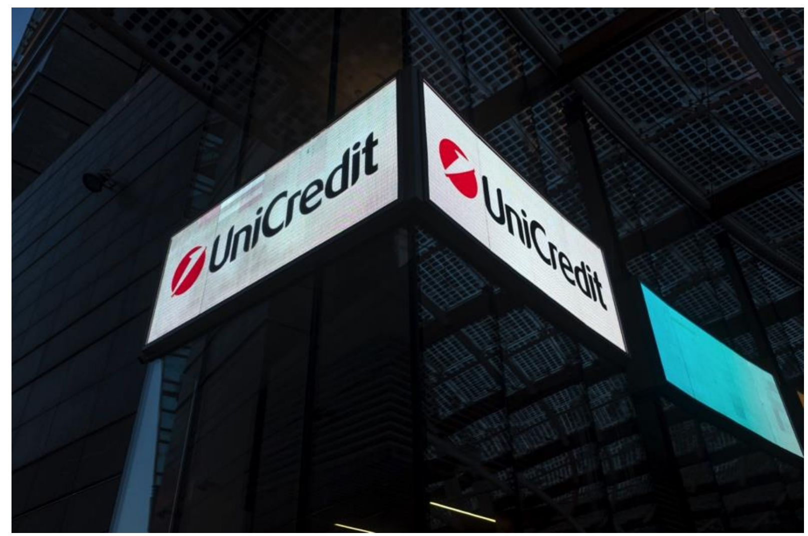
BANK NAME	HEADQUARTERS	YEAR	FINE (USD)
BNP PARIBAS	FRANCE	2014	8.9 Billion
UNICREDIT	ITALY	2019	1.3 Billion
ING	NETHERLANDS	2018	900 Million
CREDIT AGRICOLE	FRANCE	2015	787 Million
STANDARD CHARTERED	UK	2012	667 Million
ING	NETHERLANDS	2012	619 Million
US BANCORP	USA	2018	613 Million
CREDIT SUISSE	SWITZERLAND	2009	536 Million
COMMONWEALTH BANK	AUSTRALIA	2018	534 Million
ABN AMRO	NETHERLANDS / UK	2010	500 Million
HSBC	UK	2012	375 Million
LLOYD'S	UK	2009	350 Million
COMMERZBANK	GERMANY	2015	342 Million
BANK OF TOKYO - MITSUBISHI	JAPAN	2014	315 Million
BARCLAYS	UK	2010	298 Million
DEUTSCHE BANK	GERMANY	2015	258 Million
BANK OF TOKYO - MITSUBISHI	JAPAN	2013	250 Million
HABIB BANK	PAKISTAN	2017	225 Million
CLEARSTREAM	LUXEMBURG	2014	152 Million
ROYAL BANK OF SCOTLAND	UK	2013	100 Million

Source: Council on Foreign Relations, BFC Research

IV. AML: Sanctions

➢ Penalties for sanctions violations can be substantial.

- Italy's largest lender Unicredit was fined by US authorities for violating sanctions on Iran in April 2019
- Unicredit was fined USD 1.3 billion and forced to enter a guilty plea
- Among the charges was that Unicredit deliberately moved billions of dollars for clients tied to Iran, Libya, and Cuba
- This was apparently in a willful manner in a procedure specifically designed by the "core compliance team" to evade sanctions
- Bank employees were apparently instructed to not use any Iranian names and to strip the names of Iranian ships in internal documents



Source: Association of Certified Financial Crime Specialists
US Authorities hit Unicredit with $1.3 billion fine

IV. AML: Sanctions

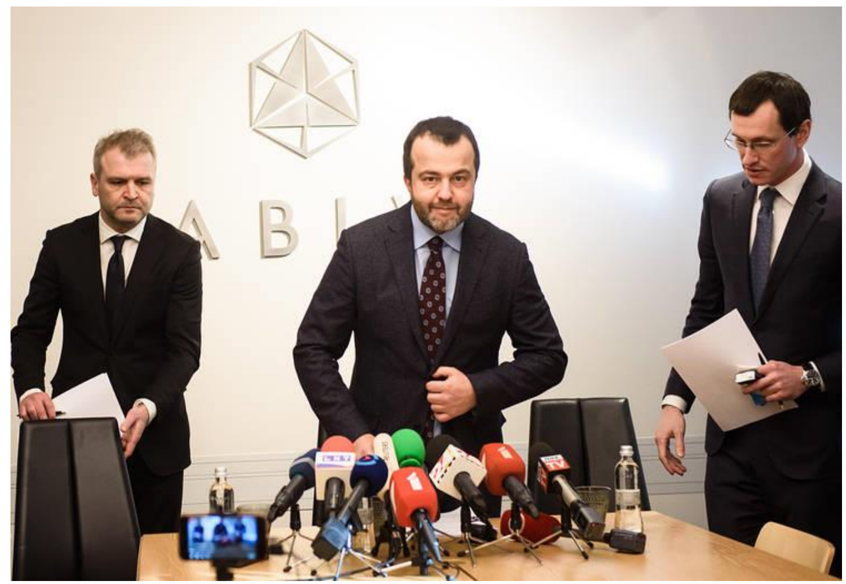
➢ **Audience question…**

"we are a bank without operations in the EU or US, out of reach of their regulators that impose multi-million dollar fines for sanctions violations.

Why should AML/CFT still be a big concern for our bank?"

Risks Beyond the Penalties

- In February 2018, the US accused Latvia's third-largest bank ABLV of institutional money laundering, having facilitated illicit transactions for sanctioned entities in North Korea, Azerbaijan, Russia and Ukraine
- The US named ABLV as an "institution of primary money laundering concern" which prevented the bank from opening or maintaining a correspondent account in the United States
- This accusation and designation lead to a withdrawal of USD 600 million of non-resident deposits, causing the bank's failure



Source: Wall Street Journal

- *Simply the accusation or rumor that a bank is involved in money laundering (or lax controls) can cause customers to take flight, or problems in their counterparty relationships!*

V. AML: International Standards

➢ The Financial Action Task Force (FATF)

- An inter-governmental body established in 1989 to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other threats to the international financial system
- FATF’s recommendations are recognized as the international standards. Most recently updated in 2012
- Monitors progress of its members in implementing necessary measures

FATF

V. AML: International Standards

➢ The Wolfsberg Group

- An association of 13 global banks that develops standards and guidance for management of financial crime risks
- Publishes principles as best practices including 2019 Trade Finance Principles (updated from 2017) to control AML risks in trade finance activities

V. AML: International Standards

- Wolfsberg Group Guidance on Customer Tax Evasion 2019
- Wolfsberg Group, ICC and BAFT Trade Finance Principles 2019
- Wolfsberg Group Guidance on Sanctions Screening 2019
- Wolfsberg Payment Transparency Standards 2017
- Wolfsberg Group Publication Statement ABC 2017
- Wolfsberg Group ABC Guidance June 2017
- Wolfsberg Group PEP Guidance May 2017
- Wolfsberg Publication Statement Guidance May 2017
- Trade Finance Principles-Wolfsberg Group, ICC and BAFT, 2017
- SWIFT Relationship Management Application (RMA) Due Diligence 2016
- Wolfsberg CB Principles 2014
- Wolfsberg Group MIPS Paper, 2014
- Wolfsberg Private Banking Principles, May 2012

the Wolfsberg Group

GLOBAL BANKS: GLOBAL STANDARDS

Banco Santander
Bank of America
Barclays
Citigroup
Credit Suisse
Deutsche Bank
Goldman Sachs
HSBC
J.P. Morgan Chase
MUFG Bank
Société Générale
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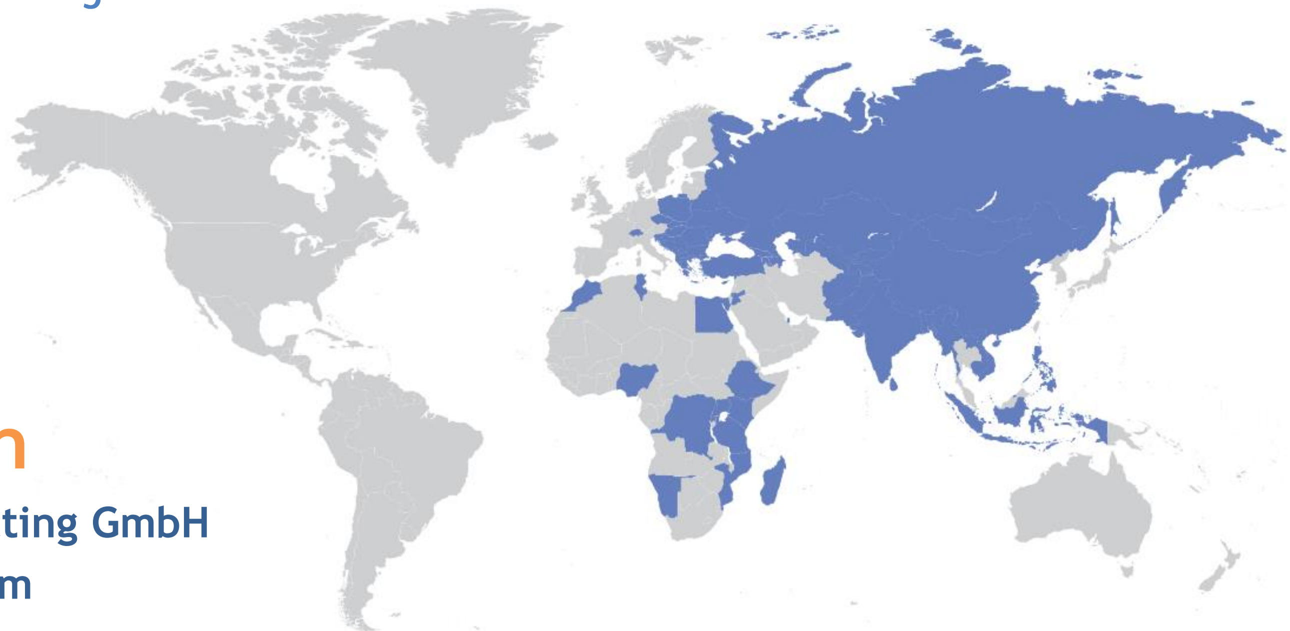

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