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Initiative generously supported by:

Training Objectives

- Build Awareness
- Provide a comprehensive understanding of Trade Based Money Laundering (TBML)
- Outline TBML risks indicators
- Provide guidance to identify Red Flags
- Share methods to combat TBML. Common controls
- Understand how to conduct thorough due diligence for Small Medium Size Enterprises (SME)s applying for bank financing
- Outline trends and developments
- Challenges for legitimate SMEs

Topics

- Background Trade-Based Money Laundering (TBML)
  - ✓ What is TBML?
  - ✓ TBML Risks
- Small Medium Size Enterprises (SME)s
  - ✓ SME Definition
  - ✓ Why focus on SMEs
- TBML risks specific to SMEs
- Red Flags to identify when SME customers may be involved in TBML
- Controls to combat TBML/Risk Mitigation Methods
- Customer Due Diligence (CDD)
- Enhanced Due Diligence (EDD)
- Considerations/Takeaways
- Final Remarks
- Resources

Background

What is TBML?

“The aim of trade-based money laundering is not the movement of goods, but the movement of money which the trade transactions facilitate.”

Trade-Based Money Laundering

is defined as “*the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illegal origin or finance their activities*”.

www.fatf-gafi.org 2006 FATF Report

How is this accomplished?

Deliberately disguising financing through activities such as document falsification (under-invoicing, over-invoicing), manipulation of goods shipped, types of goods.

Trade Finance is complex compounded by the intricacy of the supply chain/trade chain network and the associated sequencing of financial activities. TBML is even more complex involving numerous parties with interconnecting relationships, structures, and sophisticated layering.

There is ample opportunity to exploit and perform illegal activities at various points in the supply chain as well as trade finance arrangements. Further in jurisdictions where financial, regulatory, and customs controls are not mature and indicators of TBML, illicit trade, and illicit financial flows are more difficult to detect.

Small and medium sized enterprises (SME)s

SME Definition

Small and medium-sized enterprises (SMEs) are independent businesses with revenues, assets and employees below a certain threshold. Thresholds vary by country

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Determine how your bank defines a SME in terms of asset size and number of employees in order to ascertain if your customer is considered an SME

Why focus on SMEs ?

to help facilitate greater access to loans to promote the growth of small businesses in Nepal, import more overseas goods, create wealth and job creation.

- It is more complicated to identify TBML than customary money laundering but further difficult to detect in SME trade transactions.
- There is an additional layer of complexity in SMEs because they have less publicly available information, they might lack financial crime programs or may not be as robust as large corporations. This makes SMEs easier prey for money launderers.

Challenges for legitimate SMEs

More costly for banks to assess and monitor loans to a smaller, riskier company where profit is less certain relative to a larger, more profitable stable business.

SMEs may lack a robust anti-financial crime program that could provide greater confidence in a lender.

The cost of screening software technology is higher for a smaller firm with lower margins and therefore might not be prioritized over profits.

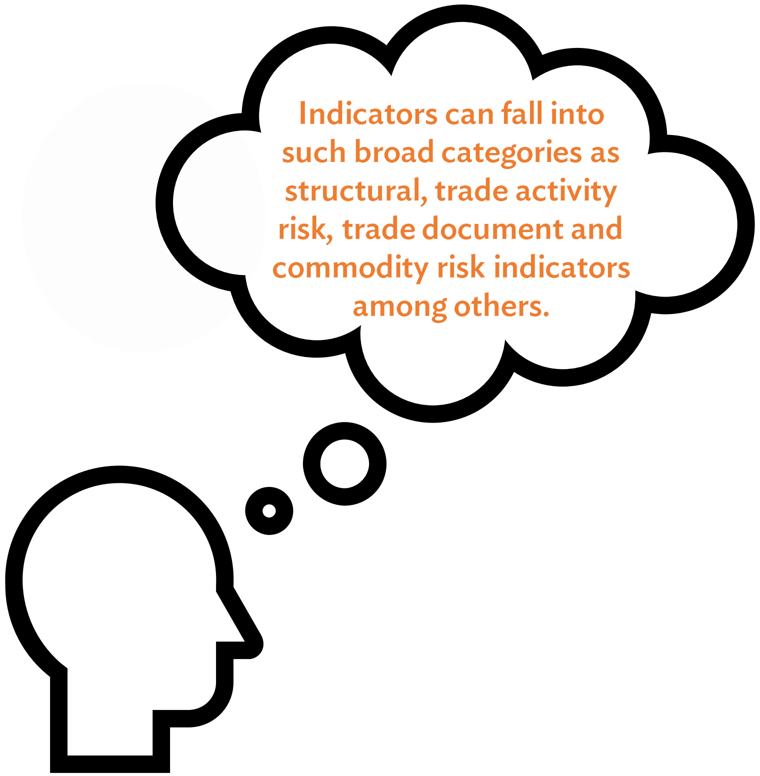
Limited collateral provisions when applying for loans.

Banks request numerous documents (which is onerous and time-consuming) such as audited financial statements, financial forecasts, business plans, details on directors and more depending on the risk appetite and thresholds of individual banks.

What do you think are the biggest barriers to trade finance for SMEs?

TBML Risk Indicators for SMEs

Risk indicators are the likelihood or occurrence of suspicious activity but may not be confirmed illicit activity, but would merit additional due diligence



→ **Inconsistencies**

Structure, business activity inconsistent with stated business, (i.e.: clothes retailer exporting computers), generic language on website or business description, # of employees vs trade volume doesn't compute, erratic business operations, lower than expected profit margins for high-value commodities, contradictions with contracts including discrepancies with names (exporter and payment recipient), quantity, quality, volume or value listed and descriptions don't make sense when reviewed holistically

→ **Overly complex** trade deals difficult to easily comprehend, involving third parties, combining different trade finance products at various stages in the trade lifecycle

→ SME has **trade partners** in jurisdictions with **weak AML/CFT compliance**

→ **Long periods of dormancy** with sudden swings in high volume and high-value trade activity

TBML Risk Indicators for SMEs (continued...)

Risk indicators are the likelihood or occurrence of suspicious activity but may not be confirmed illicit activity, but would merit additional due diligence

- **Shell/front companies** are involved as parties in the transaction
- Entity **lacks an online presence, registered at a suspect address** (residential), a high-risk jurisdiction (sanctioned country)
- Name of entity is **similar to another well-known corporation** with intent to appear affiliated
- **Personal email or incorrect email** suffix rather than a business email address
- **Phantom shipments**
- **Relevant documents missing**
- **Falsifying documents**

By no means conclusive list

Red Flags

Customer Behavior

- ❑ Evasive – avoiding routine, direct questions
- ❑ Requests for increased confidentiality
- ❑ Inconsistent information

Client Profile

- ❑ Who is your client?
- ❑ What is their profile? – Military, SME, PEP

Additional parties involved in the transaction

- ❑ shell companies
- ❑ unknown parties

Negative news from publicly sourced information

Unusual Customer Identification Circumstances

- ❑ Customer unwilling to provide personal background information
- ❑ Customer does not want mail sent to their address from the bank
- ❑ Customer has no employment records

Controls to combat TBML

- TBML Audits
- Knowledge sharing - between banks, domestic and international
- Targeted TBML training for AML/CFT team
- Suspicious Transaction Report (STR) Suspicious Activity Report (SAR)
- Suspicious transaction review and report procedures
- Ongoing transaction monitoring could result in Enhanced Due Diligence (EDD) based on findings
- Risk Assessment – to assess clients, transaction patterns, goods, services
- CDD Customer Due Diligence – specific to trade-based activities
- Know your Customer (KYC) – 1st step to a sound AML program
- Common Red Flag Internal Reference List that is regularly updated and accessible to relevant staff
- Risk-based approach (RBA) – a critical starting point to assess exposure to the risks of TBML defined as identifying the organization's highest compliance risks, making them a priority for the compliance controls, policies and procedures
- Compliance Officer/Money Laundering Reporting Officer (MLRO)

AML
ANTI
MONEY
LAUNDERING

Customer Due Diligence (CDD)

Common AML CDD

- ✓ Identify customer
- ✓ Identify the beneficial owner(s)
- ✓ Understand the purpose and nature of the business relationship
- ✓ Conduct ongoing due diligence on business, the relationship and transactions

CDD steps specific to Trade Finance customer's transactions

- ✓ Types of goods – high-risk (i.e.: weapons, chemicals) commodities, services
- ✓ Trade volumes
- ✓ Counterparties
- ✓ Complexity of transaction structure
- ✓ Shipment methods, routes (e.g., by sea or by air)

Enhanced Due Diligence (EDD)

Customers classified as HIGH RISK require MORE FREQUENT ACCOUNT REVIEWS than on an annual basis

Customer Type

- ❑ Politically Exposed Person (PEP)
- ❑ Non-resident
- ❑ Cash intensive businesses
- ❑ Unnecessarily complex structure of ownership

Geographic Location/Jurisdiction

- ❑ Countries rated by FATF as having inadequate financial crime (AML/CFT) programs
- ❑ Sanctioned countries
- ❑ Countries associated with high levels of drug trafficking, corruption, criminal activity, providing support whether financial or otherwise for terrorist organizations

Products, Services or Transactions

- ❑ Private Banking
- ❑ Non-face-to-face business relationships or transactions
- ❑ Third Parties sending payments

Considerations /Take Aways

Do you understand this transaction? Does it make sense? Does the story make sense holistically?

Reallocate resources according to banks' risk appetite

The quality of requests for information from other banks critical

Consistent and up-to-date reporting systems

Sharing knowledge, intelligence, and expertise

- **Collaboration is a necessity.** A concerted global effort will result in greater success in combatting TBML
- **Interconnected nature** of trade transactions necessitates Public-Private Partnerships (PPP)

Final Remarks

No one size fits all approach. Locations of operations, products and services, and customer types are unique for each financial institution .

Combine best practices that is likely to shift and evolve over time.

Recommendations to facilitate Nepalese financial sector to conduct business with more SME customers engaged in trade

Knowledge, information sharing cooperation, coordination, collaboration importance of sharing between banks

Develop a system for cross-referencing data from various databases in an automated manner

Recommend in-depth training on topics such as:

- TBML – covering the various types of trade transactions
- TBML Risk Assessments Methodology
- Trends and Developments
- STRS/SARS specific to TBML

Become more familiar with common patterns, typologies, schemes and developed networks

Regular Roundtables for both domestic and international constituents

Resources

- ✓ https://www.fatf-gafi.org
- ✓ https://egmontgroup.org/
- ✓ https://www.wolfsberg-principles.com/
- ✓ http://www.fatf-gafi.org/glossary/
- ✓ https://www.acams.org/en/resources/aml-glossary-of-terms
- ✓ https://www.fincen.gov/
- ✓ https://abs.org.sg/
- ✓ www.baft.org
- ✓ www.adb.org/publications/effective-practices-trade-finance-examinations

End of Presentation

Thank you!