TRADE-BASED MONEY LAUNDERING: KNOW IT, DETECT IT, PREVENT IT

Trade is fast becoming criminals' favorite way to launder dirty money, and regulators have caught on to the phenomenon, putting more responsibility than ever on trade financiers' shoulders to prevent it. Luckily, awareness, training and technology are quickly evolving to help financial institutions tackle this growing threat.

A quick news search is all it takes to realize how prominent trade-based money laundering (TBML) has become in recent years. In January 2018, the U.S. Justice Department appointed a special operations team made of Homeland Security prosecutors and investigators to work on a complex and largely trade-based money laundering scheme providing funding to Hezbollah.

Meanwhile, banks are increasingly in the spotlight when it comes to preventing or facilitating money laundering: Amsterdam Trade Bank, the Dutch subsidiary of Russia's Alpha Bank, was infamously raided by Dutch prosecutors last December in a large-scale money laundering investigation.

Recent Cases and Evolution

The Drug Enforcement Administration's (DEA) [2017 Drug Threat Assessment] exposes a few recent examples of TBML cases, and identifies the gold industry as particularly prone to laundering activities. "The exploitation of illegal gold mining and legitimate gold markets worldwide to launder drug proceeds continues to grow. Most prevalent in South America, the scheme involves the use of narcotics proceeds to purchase illegally produced gold. Documentation is created representing the gold as a product of legitimate mining operations and the gold is exported to refineries worldwide, including the United States. Given the large amounts of money that can be laundered through the loosely regulated global gold-mining sector, this is likely to remain a law enforcement focus for years to come," the paper says.

In a recent case, the Ecuadoran Ministry of Mining noticed an important disparity between the amounts of gold officially mined in Ecuador and the amount reported exported by two companies selling to U.S. refineries: between 2012 and 2014, Ecuador mined US$675.2mn in gold, but reported exports exceeded US$1.8bn over the same time frame.

Used cars are another notoriously risky sector, due to the wide array of prices these can be sold for, making over or under-invoicing practically undetectable. The Hezbollah funding investigation is partly focusing on the export of used cars from the U.S. to West Africa, the proceeds of which are believed to be ultimately collected by the terrorist organization.

Certain jurisdictions are less stringent than others in terms of money laundering prevention: in one case laid out in the Financial Action Task Force's Asia-Pacific Group on Money Laundering's (APG) Trade-Based Money Laundering Typologies Report in 2012, the proceeds of narcotics drug money from South America were first placed in a Lebanese bank. They were then layered and moved to the U.S. and Asia through the import and export of used cars and other consumer goods, and round-tripped to the same Lebanese bank through wire transfers.

Increasingly, cryptocurrency trade is being used to launder illicit money. Bitcoin's reputation has long been stained by its common use to pay for illicit activities on the dark web, and the DEA's report points to the growing acceptability of the currency as the reason for new types of TBML schemes. "China has been an enduring hub for TBML schemes through which Transnational Criminal Organizations (TCOs) purchase large shipments of 'made-in-China' goods via wire transfer or bulk cash carrying from the United States to China. Traditionally, the 'made-in-China' goods are shipped to businessmen in Mexico and South America who reimburse the Drug Trafficking Organizations (DTOs) in local currency. However, many China-based firms manufacturing goods used in TBML schemes now prefer to accept bitcoin. Bitcoin is widely popular in China because it can be used to anonymously transfer value overseas, circumventing China's capital controls," the report explains.

"Dirty" bitcoins are only used in about 1% of all bitcoin exchange transactions, according to research by the Center of Sanctions and Illicit Finance. U.S. dollars are still very much the preferred currency for criminals, but cryptocurrencies are nonetheless turning into more of a target for regulators. In November 2017, when Bitcoin was trading at US$9,880, the U.S. Committee on the Judiciary held a hearing on Senate bill S. 1241, aiming to amend the current U.S. anti-money laundering laws by subjecting prepaid access devices, digital wallets and other digital currency exchangers to reporting requirements if they contain the equivalent of US$10,000 or higher. Meanwhile, the European Parliament amended the EU Fourth Anti-Money Laundering Directive (4AMLD) in December 2017 to make virtual currency exchange platforms and wallets subject to the beneficial ownership-reporting requirements.

Detection

According to Kieran Beer, director of editorial content at the Association of Certified Anti-Money Laundering Specialists (ACAMS), the issue with TBML is that it usually involves a wide network of companies and individuals, which can make it difficult to detect. "You need to have training to look for the red flags. For financial institutions it comes down to risk assessment and understanding their customers. It's them knowing what kind of business their customers do and knowing enough about that business and their transactions to check that what they see [in the trade documentation] is consistent."

In its Trade-Based Money Laundering: Capturing the New Frontier through Analytics white paper, ACAMS classifies red flags into five categories: business structure; transactions, goods and payment structure; shipment structure; documentation; and intermediaries/third parties. Detecting TBML involves looking for inconsistencies in pricing, the types of good exported, shipment sizes, transaction structures and methods of payments, amongst others.

Various organizations, including ACAMS, offer training and certifications on trade-based money laundering, but trade finance experts lament the fact that these are generally offered to financial institutions' compliance officers, whereas the people who look at transactions on a day-to-day basis are in the trade operations teams.

More recently, technology providers have started exploring artificial intelligence (AI) uses to detect fraudulent transactions. Vendors including Pelican and Thomson Reuters have launched TBML solutions with automated compliance checks in the past two years. For example, PelicanSecure incorporates natural language processing (NLP) and machine learning (ML) to scrutinise, contextualise, understand and compare structured and unstructured data elements along the trade chain, helping to detect and prevent TBML.

But according to Beer, these technologies are still facing a number of stumbling blocks. "The big debate right now among money laundering professionals is how much AI they can use to find suspicious transactions. Those tools have actually been used very successfully in the fraud area and are slowly being adapted in the compliance area, but there's still a lot of human analysis involved. Part of that is because the compliance world feels the pressure of examination all the time from regulatory authorities. The industry is anxious to adopt these tools but is waiting for more cues from the regulators about which ones are acceptable to use," he says.

Prevention

Because of its complexity, TBML cannot be tackled unilaterally: Beer explains that only about 5% of cargo coming into U.S. ports is inspected. Moreover, banks only have visibility across a limited number of layers of their clients' supply chains, and 80% of trade is done on an open-account basis, so without any verifiable trade documents.

The consensus that has emerged in recent years is that all industries involved in trade and compliance must unite to prevent this type of illicit activity.

In 2017, the Bankers Association for Finance and Trade (BAFT) released long-awaited TBML guidance. In the document, which gathers views from trade financiers, law enforcement and legal experts, the association points to information sharing, data analytics and emerging technologies (including blockchain and AI) as three indispensable aspects of the solution.

Some jurisdictions have started to apply these principles: the UK's Joint Money Laundering Intelligence Taskforce (JMLIT) was established in 2015 as public-private partnership led by law enforcement and including several government agencies, the British Bankers Association, UK and international banks. "Such a public-private partnership has tremendous value in identifying trends as information is able to be shared in a controlled setting that may not be detected just within one institution," explains the BAFT report. "Further, by highlighting evolving trends, it enables all participants to be more targeted, and thus more effective. It also demonstrates an intangible, yet very valuable point that law enforcement, government agencies and financial institutions are all on the same team when it comes to fighting financial crime."

The U.S. Department of Homeland Security established the first Trade Transparency Units (TTUs) back in 2004. These aggregate shipment data from various sources and use a special computer system to examine trade anomalies and financial irregularities in domestic and foreign trade data to identify instances of TBML, customs fraud, contraband smuggling and tax evasion. According to one estimate, more than US$1bn has been seized since the creation of the U.S.-and foreign-based TTU effort.

Hopefully, the success of such initiatives, combined with the growing interest regulators are giving to TBML, will ensure the continuation of collaborative efforts between enforcement agencies, financial institutions and technology providers to curb illicit activities in trade.

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