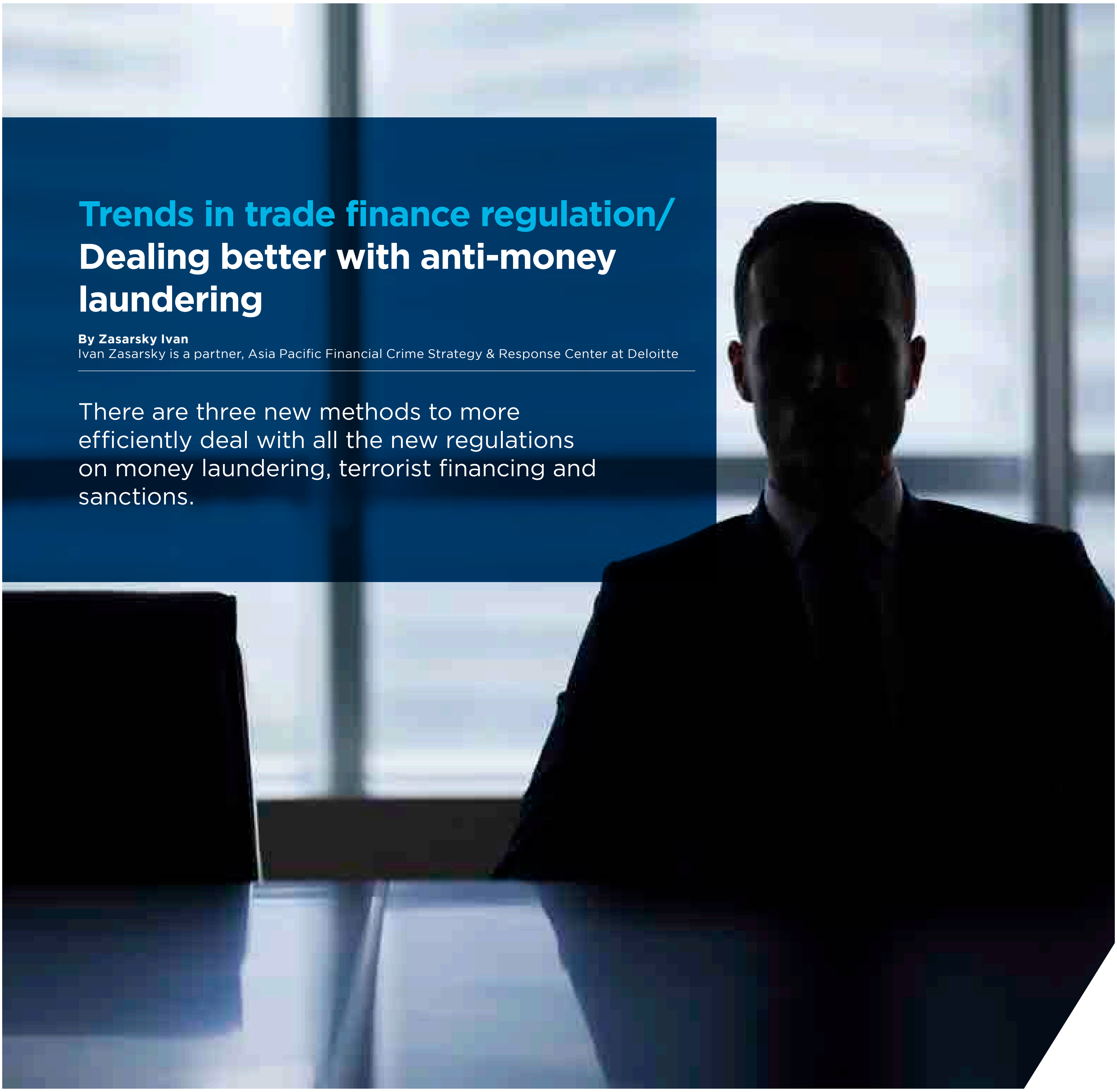

Trends in trade finance regulation/ Dealing better with anti-money laundering

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There are three new methods to more efficiently deal with all the new regulations on money laundering, terrorist financing and sanctions.

When ancient mariners sailed the seas in search of trade, they only had to worry about storms, scurvy and the figment of sea monsters.

Fast forward to 2018, and the list of a mariner's worries is much longer, and lengthening every year.

Twenty-first century container ships may be sturdier than the galleys of old, but modern trade faces a grave threat - from criminals' intent on moving illicit funds around the globe.

To deal with the risks of money laundering, terrorist financing and violating international sanctions, a life raft of legislation has been created. But with each barrier erected, criminals are inventing new ways to slip through the net of new rules.

Trade-based financial crime is one of the new techniques criminals are using. By harnessing the mechanisms of trade finance, and exploiting the blind spots in international cargo freight, criminals are able to work around the law.

Criminals are using trade finance mechanisms and exploiting the blind spots in cargo freight

Typically, criminals collude with overseas partners to under- or overcharge on invoices, transferring value by selling goods on the cheap, or getting extra funds under the guise of legitimate transactions.

It may be fairly straightforward for a customs agent to check the weight or number of items in a shipment,but gauging the true value can be more complex. This is really hard when abstract concepts or judgments are involved. The price of iron ore is easy to find online, but how much is a custom-designed engineering component worth, or a work of art? Of 220 jurisdictions worldwide, only 35 have specific anti money laundering (AML) rules for art and antiquities.

In the eye of the storm

So it comes as no surprise that some banks are having second thoughts about engaging in trade finance. More than 90% of respondents to the 2016 ICC Global Trade and Finance Survey identified AML regulation as a "significant impediment" to trade finance, up from 81% the year before.

Given the toll criminal networks and global terrorism are taking on the global economy, few would argue against tighter AML regulation. But the recent spate of legislation – not only AML, but also new sanctions against Russia and North Korea – are a huge burden on the financial institutions that keep world trade flowing.

Restricting trade finance really damages SMEs and legitimate businesses in developing countries.

For example, Africa has the world's fastest growing population, but its newly established importers and exporters, that connect the continent's young economies with foreign markets, struggle to navigate a banking system that understandably hesitates to finance their operations.

Faced with these challenges, less-established traders may seek alternative ways to transfer funds. The rise of bitcoin, a digital currency, and other cryptocurrencies poses risks. But with limited options, traders may be tempted to bypass the banking system and transact online, with no questions asked. While cryptocurrencies create new opportunities, the emerging world of virtual fiat money brings new challenges for governments and regulators.

Inexperienced traders may be tempted to bypass the banking system

As standards are raised ever higher for AML and Capture the Flag (CTF) events on information security, few would relish transactions moving out of their enforceable jurisdiction to roam freely in the dark web.

Two solutions at hand

In the right hands, blockchain technology, which gave rise to cryptocurrencies, offers solutions to some of these threats to trade finance. More traceable funds would boost transparency in the banking system and improve KYC operations in financial institutions.

Evolving technology could aid data analytics, giving more power to regulators and banks to trace proceeds and evaluate trade in goods and services.

Compliance teams can research freight arrangements, customers and correspondent banks. But it takes time and manpower. Robotic Process Automation (RPA) uses software to replicate human tasks, at a fraction of the time and cost.

If technology offers a more lucrative platform to provide trade finance, then more institutions will enter the market. More competition and improved know-how will only benefit consumers.

To realise the possibilities of this technology, banks and regulators, shipping agents, ports and customs, and many other links in the chain of international trade must cooperate more.

But as things stand, banks are focused on knowing their own customers, with only limited knowledge of counterparties and onward customers. Likewise, more accountability must rest with other members of the industry that support international trade such as shipping agents, insurers etc, all of which have visibility into the various parties and can detect suspicious matter earlier than banks.

Banks have limited knowledge of counterparts and onward customers

But with shared KYC registries, collaborative pricing data, and a clearer picture of cargo movements and whereabouts, including ships transferring goods at sea, the industry can take advantage of new technologies and help make sure trade thrives and grows in the 21st century and beyond.

Shared KYC registries, and collaborative pricing data are a way forward

In coming years, the threat from trade-based, financial crime may well become as far-fetched as the spectre of sea monsters.