A Balancing Act in Trade Based Money Laundering Compliance

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The complexity in Trade Based Money Laundering compliance... to trade or not to trade

Over the years, regulators and standard setting agencies categorised trade finance as a “higher risk” business for money laundering, terrorist financing and potential breach of sanctions. Growing complexities and volumes of trade flows create opportunities for criminal organisations to launder proceeds of crime through the international trade system.

Consequentially, Financial Institutions (“FIs”) have been facing much difficulty in monitoring and implementing controls in their trade finance business to combat trade based money laundering (“TBML”). The problem has been further exacerbated by lack of clarity in the compliance requirements and regulatory expectations in many jurisdictions.

Whilst controls can be put in place for documentary trade, greater issue lies in open account situations where the FI has far less visibility on the underlying transaction.

In documentary trades, regardless of the letter of credit (“LC”) meeting international and legal standards, where there are TBML and economic sanctions issues, it may still warrant an action from the FIs to report or otherwise take necessary steps to protect the FI, and requires the balancing art of “not tipping-off”.

Surely, the unintended consequences of the heightened risk based approach and regulatory expectations is not to stifle global trade that in turn can hurt global commerce by inter alia reducing export volumes and increasing transactions cost. There certainly is a legitimate call to balance regulatory wish lists and commercial needs for global trade to thrive. As it stands, the margins for trade transactions for FIs is thinning rapidly, attributable to competition and escalating compliance cost.

Some key challenges highlighted here include those provided in the ICC, BAFT and Wolfsberg Paper on TBML and our experience of working with the industry. Deloitte believes that these resonate with FIs given the operational difficulties they encounter. This also follows the release of the industry paper “Best Practices for Countering Trade Based Money Laundering” on 14 May 2018 by Singapore’s ‘Anti-Money Laundering and Countering the Financing of Terrorism Industry Partnership (ACIP).”

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What is the Global Regulatory Standard?

Over the last few years, standards setters such as Financial Action Task Force (“FATF”) and industry groups such as Bankers Association for Finance and Trade (“BAFT”), Banking Commission of the International Chamber of Commerce (“ICC”), Wolfsberg Group and the Hong Kong Banking Association (“HKAB”) have provided thought leadership and guidance on international standards or best practices in combatting TBML.

These, at best are, recommendation of best practices and require force of local legislation or regulations. Key regulators that have set the tone on regulatory expectations are the Monetary Authority of Singapore (“MAS”) and Financial Conduct Authority (“FCA”), United Kingdom. Few others have set the tone through inspections conducted.

Though myriad references are found on the best practices and regulatory expectations, the issues still remains in operationalising and implementing these requirements or best practices. In addition, global footprint of FIs and cross-border trades bring with it the challenge in harmonising compliance standards for FIs given that only a handful regulators have issued guidance for the industry. The question remains on which is “the standard” that FIs should imbibe, that is recognised and enforceable by their home or host regulator.

Arguably, the MAS has set the highest standard and should FIs implement their controls based on these standards, it is a safe assumption that such FIs would have satisfied expectations of all regulators they are subject to via their global footprint. Having said that, this remains a good and educated guess. Accordingly, there could be more done by regulators globally to also set their expectation and clarify their position on TBML compliance standards in their jurisdictions.

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Key Challenges

Getting the Price Right

The regulatory expectations generally are that FIs should assess the reasonableness of price of goods quoted when facilitating trade transactions. The issue faced by the industry is the lack of reliable and publicly available statistics and data on prices of myriad of goods, except arguably commodities. Complexity in price assessment is added when goods traded are, for example, spare parts and constituents or otherwise components of larger (and potentially specialised) items.

An international agreement on the level of diligence needed by FIs for “price checks” will help. This should really be based on a defined risk based approach of a FI. For example, where the customer is a known reputable business or has a long standing relationship with the FI or the price variation is within acceptable range (based on standards developed based on the FIs own data on transactions), intrusive price check may not be an automatic action to take, unless, there are anomalies noted or the price variation is not within an acceptable range. FIs may also establish their own internal database for price guidance based on the transactions handled by the FI.

Greater level of transparency can be achieved if governments, regulators or enforcement agencies and trade bodies partner with FIs to share information and establish a single, consolidated pool of commodity prices, as was recommended by ICC, BAFT and Wolfsberg.

Know the Goods Transacted

Specialist knowledge is often required to determine whether goods involved in transactions have dual-use. FIs typically have limited knowledge to ascertain this. Dual-use goods include software, technology, documents and diagrams which can be used for both civil and military applications. The goods can range from raw materials to components and complete systems, such as aluminium alloys, bearings, or lasers. They could also be items used in the production or development of military goods, such as machine tools, chemical manufacturing equipment and computers.

It is common that trade documents do not provide a detailed description of the goods or components of the same. A good practice is to generally screen goods (using preferably a paid database) to ascertain whether they have dual-use and using this with the FI’s profile of the customer and knowledge of the customer (where information should have been gathered at the onset on the goods intended to be traded), details of the transactions conducted by the customer and parties involved, length of the relationship and the issues seen during the life-cycle of the customer. The FIs may need to take a heightened risk approach with a new customer relationship where the goods traded are capable of dual-use.
Import / Export Licensing

FIs are generally not always in a position to determine if an export licence is required for a trade transaction. The counterparties to a trade transaction are in a better position to determine that an export licence is required and obtain such licence if it is required.

At best FIs can obtain advice on the typical goods that require such licences in key jurisdictions that they have exposure to via their customers and transactions, and seek their customers’ confirmation that where required, such license has indeed been obtained.

Detecting Duplicate LCs, Bills of Lading (BL) and Invoices

The question is how will FIs even know under normal circumstances that a customer is submitting duplicate or fraudulent trade documents? FIs only have access to their own information and not that of other FIs, hence, their holistic or global view on a transaction and its documentation is limited.

The best practice is to check with the issuing bank when a FI is presented with trade documents, sight the original documents and check for any obvious anomalies in the documentation over and above screening the parties involved. Relying on a MT700 message alone may not suffice. If multiple banks are seeking confirmation from the issuing bank, it should trigger a red-flag review on the part of the issuing bank who can alert the other banks and take necessary action.
Circumvented Yet Again?

Regardless of the checks conducted and controls put in place by FIs, it is difficult to confirm that a customer is involved in circumvention. When a trade ends at a port of discharge on paper which is further confirmed by end of the vessel route, it is quite an art to ascertain that the goods were transported later to a sanctioned or a high risk jurisdiction or party or otherwise routed to a jurisdiction where there are restrictions placed on certain goods. The potential use of tug boats and feeder vessels in such a situation add further complexity to ascertain circumvention. The use of these tug boats and feeder vessels blurs the ability to track vessel route as well.

FIs can only make best efforts to make enquiries to confirm that there is no suspicion of circumvention in a case where a customer trade ends at a port or jurisdiction known (based on experience) for circumvention, neighbouring a sanctioned or high risk country or a country where certain goods are restricted or where there is suspicion of transhipment without a good reason. In some ports and jurisdictions, given their international trading hub status, transhipment by known customers may be normal.
Despite the level of technology available, trade finance processes continue to be largely paper-based. This reduces the FIs’ efficiency and effectiveness in implementing risk management controls.

Continued need for manual input and review or monitoring of trade transactions is a tedious task prone to human error and arguably inadvertent human misjudgement. FIs with large trade books suffer from costly and time intensive manual review of paper documents.

Today, there clearly is a lack of holistic view of the information flows in trade transactions and seamless capability to spot red-flags in a systematic manner. Ideally, the developments we do need to urgently witness across the industry are (in no particular order):

- Digitisation of trade documents to reduce human error and expedite the process while decreasing the costs of manual trade documents and transactions review.

- Technological developments to fully automate trade transactions and implement pattern based recognition systems (which if at all may only be attainable to larger FIs) or a fully automated trade solution that tracks the transaction which performs screening, checks on vessel routes, and assess red-flags from data on the customer, documentation, transaction, shipment and payment, until the transaction is completed – with human intervention, analysis and judgment as required; and

- A blockchain solution across the industry to create a sustainable ecosystem for all parties to a trade transaction – as a utility that tracks a transaction based on digitised uniquely identifiable trade documents (we are hopeful that this materialises) and bills of lading (ideally);

Short-term digital solution: FIs may consider implementing Optical Character Recognition (OCR) capabilities in the trade finance process which makes scanned text computer readable so that relevant information can be extracted and stored in electronic form and analytic tools be applied to analyse the data for anomalies, red-flags and trends. Though this may not solve the issue in its entirety, it nevertheless is a good start to build a broader digital solution in a modular fashion.
Conclusion

What’s next?

With the growth in the volumes of international trade and given the complexity in the trade finance business, improving TBML compliance measures and controls require a collaborative effort between relevant agencies and FIs.

To summarise, global and inter agency cooperation needed with the industry on:

- Creating global trade data for price-checking purposes.

- Agreeing on the reasonable standards for due-diligence required on the part of the FI with regards to dual-used goods. Practically, unless it is an outright red-flag or a weapon of mass destruction, it is quite difficult to determine whether some items are going to be used for dual or wrongful purpose. For example, certain chemicals or chemical content of goods such as fertilizer, cannot always be concluded as being intended for dual use by a customer whose business is to manufacture chemicals or fertilizers or otherwise by a customer who has an established need or use of these in their customary business.

- Policy shift towards including key parties in a trade transaction to also play their part – rules should equally apply on importers and exporters (for example, pre-registration with customs before these parties can conduct international trade which pre-registration should be reliable for the use of FIs), importers and exporters should conduct KYC / CDD on their clients, shipping companies should check on the buyers and sellers, goods being transported and ensuring that IMO numbers are provided on the BL and insurers to conduct CDD on the parties at the same standards that FIs do for trade transaction purposes.
• Customs authorities could mandate unique identifiers for goods imported and exported, dual-used goods and restricted or embargoed goods should require pre-certification from customs before the use of any banking facilities and monitoring of tug boats feeder vessels use. This is for example, mandating the provision of the Harmonised System (HS) Classification of Goods and International Maritime Dangerous Goods Code (IMDG) to assist Banks in screening goods or assessing red-flags related to goods.

• Global agreement on TBML regulatory standards which are harmonised across all jurisdictions to create clarity for FIs and a level playing field regardless of location of the FI and size of business given that the risk remains the same regardless.

• Establish Trade Transparency Unit which enables global partnership to leverage trade data as well as import/export data from other participating countries to effectively analyse trade information.

• More could be done to streamline procedures to help detection of duplicate BL where shipping companies could potentially "centrally" register a BL they have issued which can be checked by the Bank for authenticity.

• Given the complexity of trade transactions (and transactions monitoring globally), regulators and enforcement agencies could support an initiative to conceptualise an industry wide surveillance system where a FI should be able to holistically view or visualise a trade transaction and parties involved in the same. This should in turn sharpen the ability of the FI to conduct transactions monitoring or surveillance and red flag detection based on the information and data available. The current impediment faced by the industry is that a given FI has only a limited view of a small part of the transaction which is not always helpful in detecting anomalies and red flags.

We urge for intelligence sharing across regulatory and enforcement agencies, and the industry as an imperative way forward. Needless to say that resources spent on CDD / KYC, transactions monitoring and manual reviews conducted by FIs is not producing intended results in all cases despite much effort.

Accordingly, a paradigm shift in the manner in which surveillance is undertaken has to change to become cutting-edge with greater public private partnership and, ultimately, creation of an eco-system for global view of trade transactions, as suggested above.
Contact Us

Radish Singh
Partner, South East Asia Financial Crime Leader
Singapore

T: +65 6530 8077
M: +65 9785 4580
E: radishsingh@deloitte.com
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