Tricks of the trade

Aamar Ahmad provides some case studies of common challenges faced by financial institutions when processing trade finance transactions

There are three main methods by which criminal organisations and terrorist financiers move money for the purpose of disguising its origins and integrating it into the formal economy. The first is using the financial system; the second involves the physical movement of money (e.g. using cash couriers); and the third is through the physical movement of goods through the trade system. In recent years, the Financial Action Task Force (FATF) has focused considerable attention on the first two of these methods. By comparison, the scope for abuse of the international trade system has received relatively little attention.[1]

However, recently there has been heighted focus from both governments and regulatory bodies on trade-based money laundering (TBML), resulting in enhanced pressure on financial institutions (FIs) to do more to combat financial crime through the physical trade of goods. Although many FIs have invested heavily in KYC, screening and transactions monitoring systems many illicit trade finance transactions are still processed by the banks without any suspicion.

This article considers three common challenges faced by FIs when processing trade finance transactions, in the form of the following case studies:

- The 'tick box' exercise
- Relying upon the clients
- Excessive time pressure.

Case Study 1: The 'tick box' exercise (livestock transaction)
Trade finance processing is probably the least automated function within FIs, and many rely heavily on manual processing. This results in significant pressure on trade finance processing staff to quickly complete paperwork without really understanding the transaction. A commonly-used phrase within trade finance is that "documentary trade processing staff are paid to process not to think", a fact that I have observed many times in the years that I have been investigating trade finance transactions. The following case study shows how staff at a FI failed to identify several red flags yet decided to proceed with a transaction.

Stage 1: Receipt of SWIFT message to advice on Letter of Credit

Applicant:	Panorama Industries Ltd
Beneficiary:	Sky Dairy SA
Port of Loading:	Buenos Aires, Argentina
Port of Discharge:	Abuja, Nigeria
Product:	Livestock
Transaction Value:	$1.3m

This transaction passed every standard check, including a dual use goods check on the product, sanctions checks on the applicant and the beneficiary, and adverse media checks on all parties involved. Hence, every box was ticked. Yet significant red flags were not identified. For example;

- Product details are very generic (i.e. 'livestock') and no efforts were made to understand exactly what kind of livestock were being imported.
- Although a dual use goods check was performed on 'livestock', the outcome was 'passed' because the term 'livestock' is too generic and the actual product was not searched since it was unknown to the FIs
- The port of discharge is 'Abuja'. However, there is no port in Abuja as it is landlocked
- The transaction value appears to be $1.3m. However, the value is irrelevant unless the quantity and quality of product is known, enabling the performance of a price check
- No consideration was given to geographical details (i.e. does it make economic sense for an African entity to import livestock from Latin America?).

Stage 2: Compliance intervention and receipt of further information

Upon further discussions with the relationship manager and operations staff, the following information was revealed:

- The actual product was 'cows'
- The purpose of the transaction was for a restaurant in Nigeria, which had the selling point that its meat was imported. Hence, good quality meat was being imported from Uruguay
- The port of loading was 'Buenos Aires airport' and port of discharge was 'Abuja airport' ►

- The relationship manager was fully comfortable with the transaction, since it is common practice to offer imported meat in Nigeria.

Stage 3: Assessment of further red flags
Information received from the relationship manager only resulted in further question marks on the credibility of the transaction, including:
- Why would a client directly import live cows from another continent instead of sourcing from within Africa?
- Why would a client use air transportation to import live animals?
- How much would it cost to transport cows worth $1.3m using aircrafts?
- How many aircraft are chartered to import live cows?

Stage 4: Rejection
Upon extensive discussions between the relationship managers, trade finance operations and compliance experts it was eventually decided to reject the transaction due to several red flags. It was evident that trade processing staff as well as business relationship managers did not make any efforts to understand the details of the transaction. Instead, a 'tick box' approach was carried out and, in the absence of any dual use goods alert and sanctions alerts, the trade processing team decided to proceed with the transaction. However, eventually the compliance department identified the red flags during *ad hoc* checks and managed to stop the transaction before any funds were transferred.

Case Study 2: Relying on Clients (Raw Materials for Tobacco Industry)
Absence of a complaint or an issue does not mean there is no criminal activity taking place. A common misconception among frontline and trade processing staff is that if a transaction flows smoothly then it is legitimate. However, money laundering is carried out quietly through collusion between two parties. The following transaction is a prime example of an illicit attempt to circumvent currency controls measures, as well as to possibly defraud the firm acting as applicant of this letter of credit.

Stage 1: Receipt of SWIFT message to advice on Letter of Credit

Applicant:	Star Tobacco Private Ltd, Kenya
Beneficiary:	Sky Electronics JSC, Turkey
Port of Loading:	Istanbul Airport, Turkey
Port of Discharge:	Nairobi Airport, Kenya
Product:	Raw material for tobacco industry
Transaction Value:	$14,000

The above transaction passed all standard checks, including dual use goods as well as sanctions checks on the applicant and beneficiary. A fundamental issue related to this transaction was that no efforts were made to truly understand the transaction because the applicant of the transaction (importer) was well known to the advising bank.

Although standard checks were performed to ensure all boxes were ticked, no efforts were made to truly understand the transaction, including:
- The true nature of product was unknown ('raw materials' can be anything, including a dual use good)
- No information on quality or quantity of the product was obtained. It is impossible to conduct an over/under price sense check with an absolute figure of $14,000 without knowing further details, including quality of quantity of the product
- An absolute round figure is usually considered as a red flag and no effort was made to investigate this further.

Stage 2: Compliance intervention and receipt of further information
Upon further discussions with the relationship manager and operations staff, the following information was revealed:
- There was initial resistance from the client to provide further information on the actual products
- The actual products were 'ethernet switches', 'computer processors' and 'memory disks'
- The price of almost every component was 10 to 100s times over-inflated. For example, an ethernet switch may be purchased for $15, although according to the invoice presented the exporter was charging over $1,400 for each ethernet switch
- The products may still be used in the tobacco industry (i.e. as 'office equipment'). However the initial product information 'raw materials for tobacco industry' was misleading
- The relationship management team was very comfortable with the transaction given the fact that client was known to the FI and believed that there was no need to suspect any wrongdoing from the client.

Stage 3: Assessment of further red flags
Upon receipt of invoices a number of new red flags were identified including significant overpricing of the underlying products, as well as provision of misleading information on the nature of product on the onset of the request to advice on the Letter of Credit. The client was requested to explain the significantly higher prices of the underlying product. Their response was that there was an error on the invoice which contained incorrect information on the quantity of the products. The client refused to provide any further information.

Stage 4: Rejection
Discussion between the compliance and relationship management team resulted in the mutual decision to reject the transaction. Although the relationship management team initially was very reluctant to even ask their well-known client for further information, upon further investigation and receipt of conflicting information from the client, and refusal to provide any further information, the relationship manager decided to reject this transaction and include the client on the FI's internal blacklist. ►

Case Study 3: Excessive time pressure (straws from the Far East to Africa)

Large volumes of transactions present an excellent opportunity for criminals and a great challenge for FIs. Every day hundreds of thousands of trade transactions are processed by FIs. Criminals may attempt to impose excessive pressure on FIs to process their transactions as quickly as possible, leaving very limited time for the processing staff to carry out thorough checks. The following case study highlights one such scenario.

Stage 1: Receipt of SWIFT message to advice on Letter of Credit

Applicant:	Prime Resources Nigeria Ltd
Beneficiary:	Premier Trading Indonesia PT
Port of Loading:	Jakarta Airport
Port of Discharge:	Lagos Airport
Product:	Drinking straw pipes
Transaction Value:	$4,000

Dual use goods checks on the product and the importer/exporter did not yield a negative result and the operations staff decided to proceed with the transaction. The compliance department randomly picked this transaction for review before agreeing with the client on advice for this Letter of Credit. Notable concerns about this transaction included the absolute transaction value of $4,000 and the use of airway transportation for a product that is very cheap, non-perishable and consumes a lot of space (indeed, perhaps hundreds of thousands of drinking straws may be purchased for $4,000).

Stage 2: Compliance intervention and receipt of further information

The issuing bank (a client of the FI, acting as advising bank) called several times within the same day pressuring the FI to confirm the Letter of Credit. The issue was escalated to compliance for advice. Upon further discussions with the relationship manager and operations staff, the following information was revealed:

- The applicant and beneficiary (importer and exporter, respectively) were both unknown to the FI (advising bank)
- The transaction had to be confirmed immediately otherwise the importer might take their business to another bank (i.e. threat to issuing bank)
- The reason provided for air shipment was that there was a significant shortage of the product in Nigeria due to huge demand around the Christmas season
- The importer presented a copy of an airway bill upon request

Stage 3: Assessment of further red flags

A number of further red flags were identified upon receipt of airway bill, including;

- The black and white photocopy presented as the airway bill was not very clear
- The freight amount mentioned on the airway bill was over $42,000 (i.e. the cost of freight was over 10 times more than the cost of the underlying product)
- The justification of airway shipment was not convincing (i.e. demand due to Christmas). Every sound business understands well the demand cycle of their products and no sound business will spend $42,000 on freight for a product with an underlying cost of only $4,000.

Stage 4: Rejection

The compliance, trade finance sales and operation teams worked collaboratively on this transaction, while the counterpart tried the technique of applying extreme time pressure. Although initial checks on the product, importer and exporter did not result in any alert, further investigation into the details helped identify several other red flags and eventually resulted in the rejection of this transaction. The importer/exporter were placed on the internal blacklist.

Vigilance, training and support

Trade finance transactions may appear very simple. However, relying exclusively on sanctions, dual use goods checks, and screening against internal watchlists may not be enough. As the case studies illustrate, vigilance from the compliance and operations staff and effective understanding of the products and services are necessary to effectively risk assess trade finance transactions. Criminals use various techniques in an effort to deceive FIs (e.g. using generic terms for products, such as 'raw materials' and 'tools' instead of providing actual product details). Applying excessive time pressure, particularly at the 'last hour' is another method used, aimed at forcing the FI to make quick decisions without proper investigation.

Bespoke training of frontline, operations and compliance staff, supported by technology solutions, is the most important tool that FIs can use to identify, assess and mitigate financial crime risks within TBML.

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1. https://www.fatf-gafi.org/media/fatf/documents/reports/Trade%20Based%20Money%20Laundering.pdf