Raising awareness

Aamar Ahmad considers the impact of the pandemic on the financial crime risk associated with global trade, and the need to raise staff awareness

Financial institutions consider the global trade of physical commodities as a higher-risk activity from a financial crime compliance perspective. Due to the involvement of multiple jurisdictions and stakeholders, and the numerous stages of a global trade transaction, it can be difficult to effectively detect, monitor, and mitigate financial crime risk.

Although financial institutions may decide on a risk-based approach to modify their screening approach, this tactic of reducing the scope of screening may expose the financial institution to a significant residual risk of failing to identify any bad actors within a trade transaction

Organised criminal networks take advantage of such complexities to launder funds, evade taxes, commit fraud through document alteration, or breach global sanctions. Common typologies include: over-pricing, under-pricing, variable volumes, phantom shipments, false description of goods, misrepresentation of the actual beneficiaries, and making payments to unrelated parties, to name just a few.

The challenges facing financial institutions in this area have been heightened during the ongoing global pandemic. For example, counterfeit personal protective equipment (face masks, protective gowns, and gloves for medical staff etc) has been one of the most reported frauds in recent months. This article highlights some of these challenges.

Restricted access

Trade finance is typically a very manual, paper-based service offered by financial institutions. Although significant efforts are underway to automate the processing of global trade transactions, the industry is years away from full automation.

The pandemic has added further difficulties for financial institutions in dealing effectively with complex global trade and the applicable regulatory requirements. Among the biggest challenges created by COVID-19 is the restriction it has placed on access to trade documents for physical inspection by trade processing staff members. Most of the important documents linked to a trade finance transaction require physical inspection, e.g. validating the authenticity of the trade document, checking water marks and wet ink signatures on various documents including bills of lading, certificates of origin and inspection certificates etc. While many banking staff based in the developed world are able to work from home, physical documents are typically delivered to corporate office locations, with lack of access to these original documents resulting in limited ability for trade operations staff to validate their authenticity.

Resource constraints

Another obstacle facing financial institutions results from their significant reliance upon offshore operations centres, mostly located in developing countries. Many large financial institutions have thousands of employees in offshore ►

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centres, who lack access to reliable technological resources, such as work-laptops and high-speed internet connectivity.

There is therefore a substantial risk for financial institutions in terms of significantly reduced availability of offshore staff to perform crucial documentary checks. Existing staff members in developed countries (who are typically much fewer in number) may not be able to perform all applicable checks on the legitimacy of trade transactions. This challenge may be exacerbated if staff are unable to work due to sickness/self-isolation.

Consequently, several financial institutions have modified their procedures to reduce the checks performed on trade transactions. Although this is a permissible tactical solution on a risk-based approach to make best possible use of available resources, there remains a high probability of failing to identify certain red flags when thorough checks are not performed due to resource constraints.

Screening the involved parties within a trade transaction is a crucial step in identifying red flags and possible sanctions breaches to comply with regulatory requirements as well as internal policies. Generally, banks screen all parties involved in a trade transaction, which more often than not generates a significant number of alerts. Screening involves sanctions connections, PEP status as well as any adverse media alerts. If a screening engine is not tuned correctly, dual use goods screening has the ability to generate a significant number of alerts that will have to be reviewed.

Staff in offshore operations centres may not have access to the full suite of their institution's systems, which increases substantially the risk for financial institutions as there is a continual build-up and backlog of alerts pending review. Again, some financial institutions have introduced tactical solutions through tweaking their sanctions screening software in the form of screening only selective parties instead of screening all parties to a trade transaction. Although financial institutions may decide on a risk-based approach to modify their screening approach, this tactic of reducing the scope of screening may expose the financial institution to a significant residual risk of failing to identify any bad actors within a trade transaction.

Over/underpricing

Historically it has always been difficult for financial institutions to effectively mitigate over/under pricing risk. However, the significant price volatility and large-scale fluctuations from the supply and demand perspective resulting from the pandemic have compounded the challenge for financial institutions.

A number of scandals have been exposed over the last few months in which organised criminal groups have attempted to launder substantial sums of illicit funds through over/under pricing of underlying products, attributing the price disparity to a significant shift in supply and demand. One recent scandal included the Bolivian Health Minister, who was arrested in May 2020 for authorising the purchase of medical equipment (ventilators) for the price of €27.6k per unit through an intermediary, whereas the intermediary purchased the ventilators for €9.5k per unit from the manufacturer. The Health Minister is accused of authorising a payment of nearly €5m, three times higher than the amount of the actual value of goods for the benefit of the intermediary who, incidentally, is based in a foreign country.[1]

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Paramount importance

It is of paramount importance for financial institutions to raise awareness among their staff members around emerging typologies of financial crime through global trade. The best control to mitigate the risks of financial crime remains the ability of staff members to first identify the red flags within a trade. Bespoke training for trade processing and compliance staff members should be the key priority for financial institutions. Indeed, a lack of bespoke training has been highlighted as a key gap by the UK Financial Conduct Authority.[2]

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