

Industry and Academia Technology Control Best Practices

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Trade Based Money Laundering

Trade Based Money Laundering is of High Risk

Trade Based Money Laundering (TBML) was recognized by the Financial Action Task Force as one of the three main methods by which criminal organizations and terrorist financiers move money for the purpose of disguising its origin and integrating it back into the formal economy.

TBML









TBML is the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origin (FATF).

Why is TBML so prevalent?



- The key is with its complexity, as not only does it involve sectorial boundaries but also (often multiple) national borders (International Trade).
- The enormous volume of trade flows, which obscures individual transactions and provides abundant opportunity for illicit transfer of value across borders
- The elevated use of effective AML Controls by Financial Institutions are pushing financial criminals to use more complex schemes and techniques to smuggle funds and manipulate the Financial System.
- The limited resources available to agencies wanting to detect money laundering & open account trades

Main challenges

 The expansion of International Trades	 Reliance on large volumes of complex documentations
 Limited information sharing between banks and countries	 Complexity of trade products and trade financing arrangement
 Lack of statistics and standardization of data	 General lack of awareness of TBML issues

TBML Red Flags

5 broad categories that should be considered together

Customer Red Flags

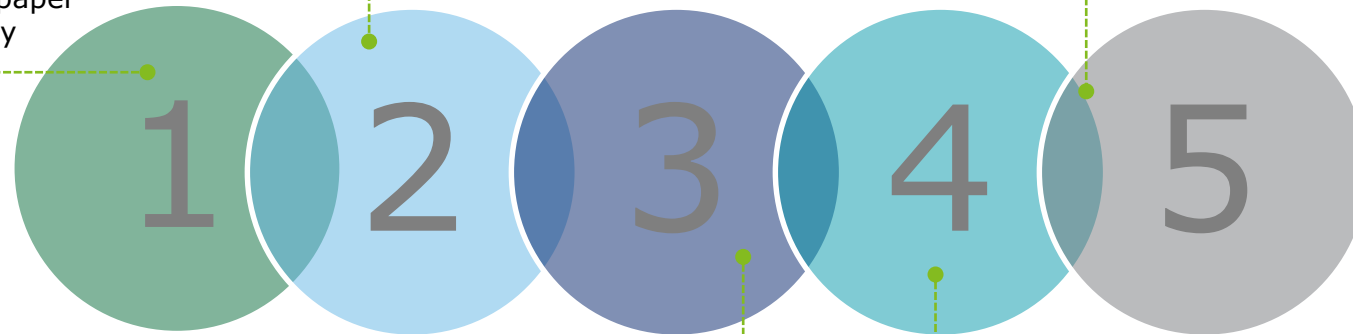
Capture the unusual activities and requests of the client such as engaging in transactions which deviates from regular business strategy or transactions which lack business sense
e.g. Steel company that starts to deal in sugar and paper products frequently

Document Red Flags

Encompass abnormality in documentations commonly required in trade finance such as Letter of Credit and Bill of Lading. Incomplete or dubious documents may warrant increased scrutiny and due diligence effort *e.g. Shipment locations of the goods inconsistent with LC; actual shipment occur in high risk country such as Iran*

Shipment Red Flags

Concern about the nature and characteristics of the actual goods to be shipped/received, particularly if shipping method does not make economic sense or highly unlikely due to the weight/quantity/value of the goods. *e.g. Using forty-foot container to transport small amount of low-value goods*



Transaction Red Flags

Specific transaction terms and structure which are incoherent with industrial norms and potentially do not make economic sense, such as request to include clauses which seek to benefit buyer/seller
e.g. Complex transaction structure across numerous intermediaries without supporting reasons

Payment Red Flags

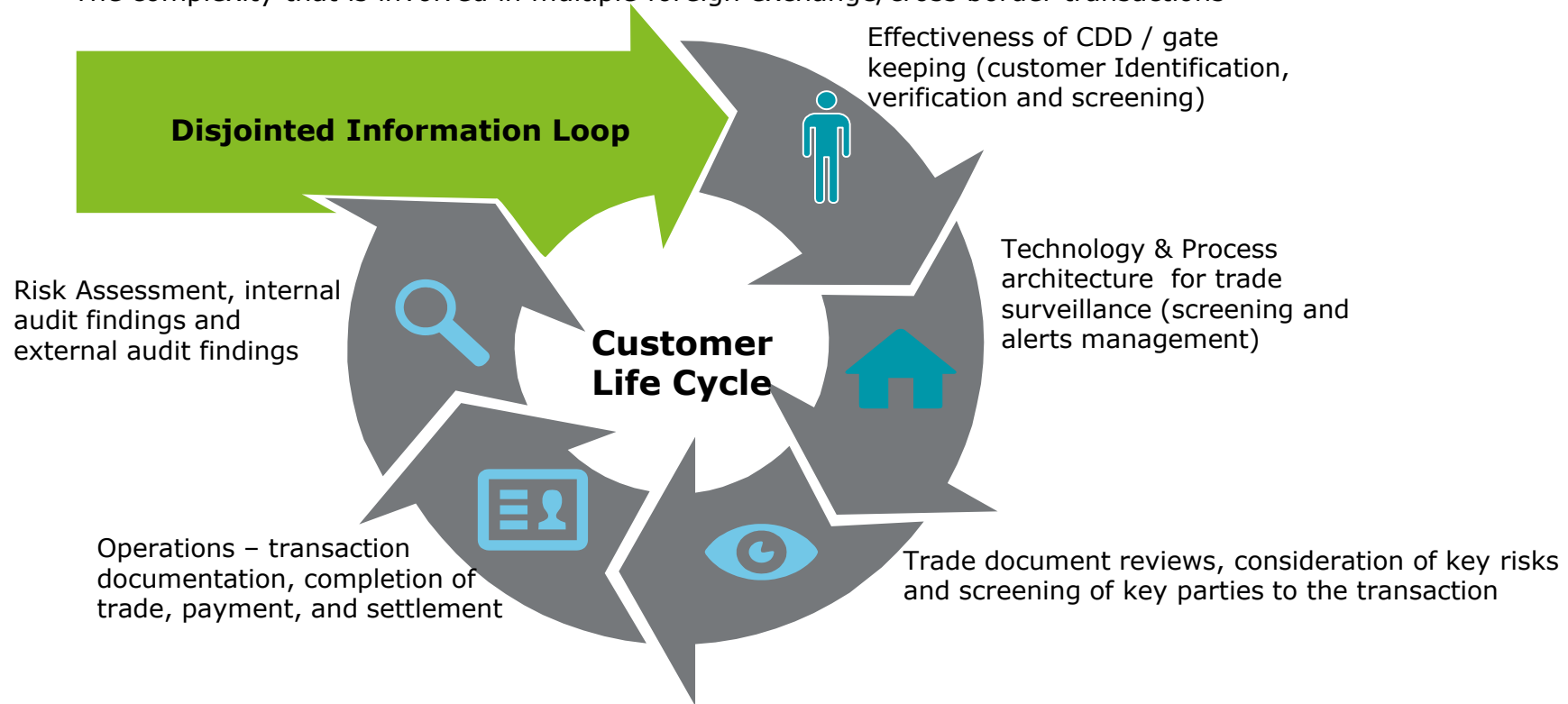
Terms of payment which appear to be highly unusual or complex and may involve specific clauses to obscure the true identify of the ultimate beneficiary
e.g. Request to pay third party in cash and payment in tax-haven or high banking secrecy jurisdiction such as BVI

Common Issues and Key Risks

Trade Finance Business - Key Risks & Issues

Trade Finance has become a popular instrument for Money Laundering as:

- The tremendous volume of trade makes it easy to hide individual transactions
- The complexity that is involved in multiple foreign exchange/cross border transactions



Issues

- Lack of clear policy & inconsistent approach to risk assessment with no specific TBML based risk assessment
- Inability to demonstrate that ML risks had been taken into account when processing particular transactions.
- Trade processing staff do not make adequate use of CDD information gathered by relationship managers or trade sales teams.
- Little or no management information on financial crime risks in the trade finance business.
- No escalation of potentially suspicious transactions for further review and more senior level sign-off on the basis of ML concerns. Transactions were usually escalated for sanctions reasons or because the value of the transaction had exceeded a pre-determined threshold.
- Inadequate systems and controls over dual-use goods
- Trade processing teams do not make adequate use of the significant knowledge of customers' activity possessed by relationship managers or trade sales teams when considering the financial crime risk in particular transactions

Trade finance Key Risks & Issues

Key Challenges and its impact (1/2)

Transparency Challenges

Challenges

- There is a lack of reliable and publicly available statistics and data on market prices of goods and commodities traded that gives rise to the misrepresentation of the value of goods traded.
- One of the most significant TBML technique to move illicit funds is done through trade mis-invoicing, which includes 'over' or 'under' invoicing of goods.

Impact

- Price verification for financial crime control purposes is difficult.
- Difficulty in making meaningful determinations on legitimacy of unit pricing due to the lack of relevant business information, such as the terms of a business relationship, volume discounting or the specific quality of the goods involved.
- Many products not traded in public markets - no publicly available market prices.
- Regulatory pressure on the FIs continue to increase as the lack of a single, consolidated pool of commodity prices reference point impedes FIs' effort in implementing market price assessment controls to fulfil regulatory requirements.

Understanding Nature of the Goods Transacted

- Dual-use items are goods, 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.
- Specialist knowledge is often required to determine whether or not goods involved in transactions have dual use and therefore, FIs have limited knowledge to ascertain this.
- Documents used in trade finance arrangement either rarely contain a detailed description of the product or of the goods transacted.

- Without the necessary technical qualifications and knowledge across a wide range of products and goods, it is difficult to identify products and material in relation to dual-use goods.
- The ability ascertain dual use goods part played in transactions becomes an uphill battle.

Trade finance Key Risks & Issues

Key Challenges and its impact (1/2)

Due Diligence Checks and Controls

Challenges

- In the current regulatory climate, FIs are expected to establish and subject parties identified as a trade customer to the bank's customer due diligence ("CDD") process.
- Despite this, FIs involved in international trade continue to be vulnerable to money laundering risk.
- Further, with the use of open account trades, an FI will only be able to see the netting payment rather than the underlying transaction

Impact

- Difference in standards across jurisdictions may impede global standardisation of due diligence requirements in trade finance transactions and can lead to issues in respect of a FI's reliance on respondent FI's systems and controls to conduct appropriate due diligence.
- FIs are further exposed to the ML/TF risk if "nested" correspondent banking relationships or accounts are not properly identified. The third-party FIs and its clients can easily gain anonymous access to the financial systems.
- The use of open accounts reduces the transparency of underlying trades. Only banks that are offering proprietary Open Account facilitation mechanisms (e.g. purchase order management capabilities, invoice discounting, etc.) may have greater insight to the transaction.

Paper-Based Trade Finance

- Despite the level of technology available to be more effective at combating criminal activities, trade finance processes continue to be largely paper-based.
- This reduces FIs' efficiency and effectiveness in implementing risk management controls.

- FIs with trade finance offerings suffer from costly and time intensive information matching and the manual review of paper documents lead to delays in the transfer of goods, initiation of payment or release of funds.
- There is a lack of holistic view of the information flows in trade transactions and understanding misconduct that takes place between a buyer and a seller
- There is a limitation faced by FIs wherein their effort to put in place suitable controls to prevent financial crime in their business is hindered by the limited information or details furnished to the FIs.

Other Key Points

Due to the number of parties involved in a trade transaction and limitation on the flow of information, relevant stakeholders at both a national and international level (e.g. government, Customs agencies, FIUs) should continue to recognise the need for on-going participation and co-operation in ensuring financial crime is not facilitated through Trade Finance activities.

Challenges

- Hurdles with controls on data protection and cross border information exchange
- Differing jurisdictional standards may impede global standardisation of due diligence requirements in Trade Finance transactions.
- Transactions involving multiple parties and transfers of ownership may disguise the true nature of a transaction, where such information may not be apparent to the FIs involved in that transaction.

Limitations

- Many trade transactions are only a part of a related chain of transactions and the FIs involved will have a view for that transaction only.
- Countries known to be involved directly may be named in sanctions, but countries which are technology producers or are “diversion risk” countries used for the transit or re-export of goods may well not appear on any warning lists.
- Whilst FIs are a primary conduit for the movement of funds, substantial participation from other key stakeholders is required in order to provide an effective deterrence effort and to aid the detection or discovery of the relevant targets in this area.

Export License

- FIs are generally not in a position to determine, at any stage in a trade transaction, whether an export licence is required, or whether the commercial counterparties to the trade have obtained a valid export licence.
- It is the commercial counterparties to a trade transaction that, in the first instance, should determine whether an export licence is required and that should obtain such a licence if it is required
- The Paper recommends that relevant authorities should publicise names of individuals and entities that have been denied export licences.

Using Technology in TBML / Financial Crime Compliance

Key resources in combating TBML

Given the complicated nature of TBML compliance needs, it is important to use the right tools, technology and resources to help combat TBML

1

Monitoring red flags in the transaction

Financial institutions should leverage on the large historical transaction database to identify TBML red flags and techniques which can be used as a benchmark for analysis and scenario testing. The red flag repository will serve as the baseline for the development of a roadmap for the implementation of a TBML framework.

2

Advanced Data-driven Solutions

Using existing electronically recorded trade data, inductive analytic approaches like as Self Organising Maps (SOMs) and statistical reconciliation of transactional prices can be employed to identify higher risk situations and pricing anomalies.

3

Statistical Profiling Methodology

Financial institutions should consider the use of in-house historical trade data to identify abnormal trade price (i.e. above average or below average trade price).

4

TBML centric Transaction Monitoring System

Financial institutions need to build a trade finance centric transaction monitoring system which takes into consideration trade finance specific red flags and typologies. Additionally, financial institutions should pursue an automated approach to transaction monitoring to make the process less laborious and less prone to human error.

5

Public-Private Cooperation

Increasingly government regulators and law enforcement agencies are partnering with financial services institutions in certain circumstances to share information and approaches. Government-led initiatives such as the US Trade Transparency Units offer a potential venue to collaborate and share critical intelligence .

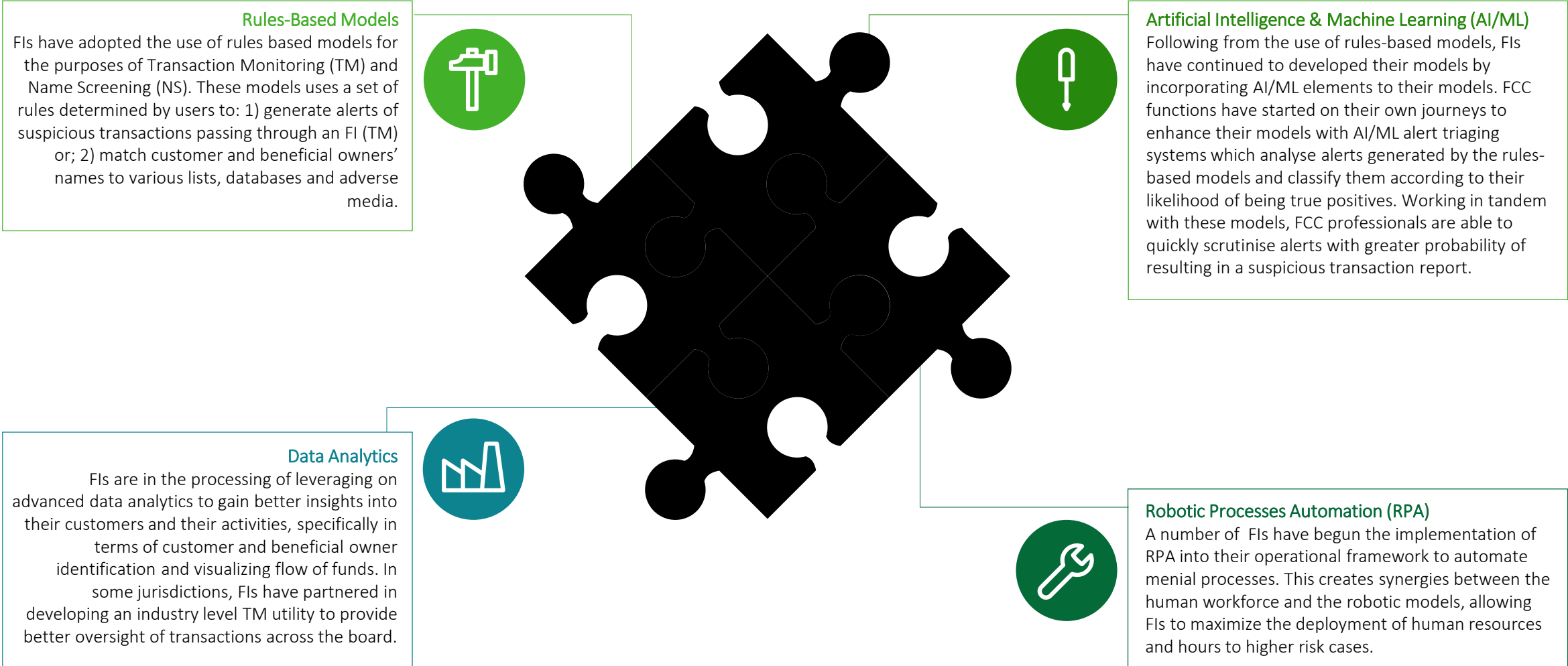
Current Issues and Solution – Use of Technology to Combat TBML

New technologies (AI, NLP, OCR, Machine Learning, etc) can be used to address some of the issues

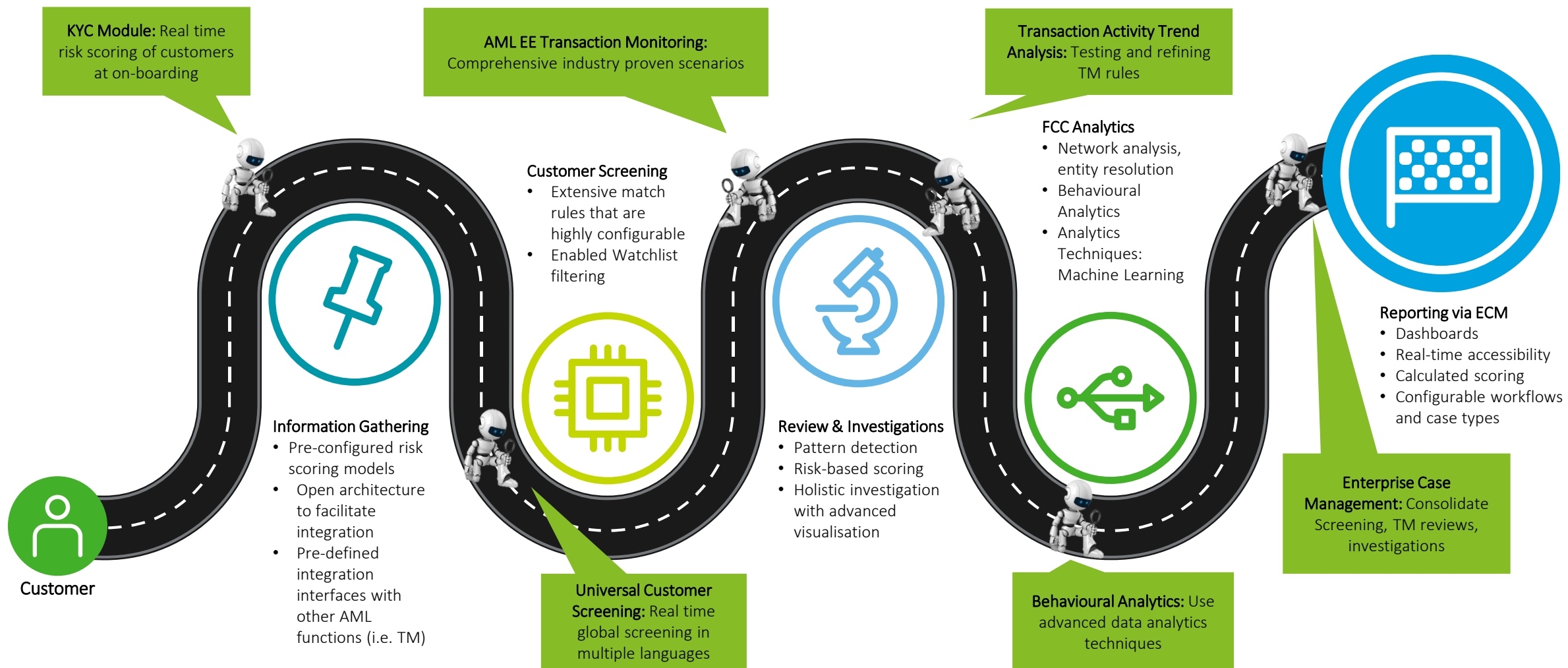
- Key issues remain in lack of digitization in underlying documentation and complexity of the transactions - international trade is susceptible to financial crime
- Over the years, regulators and standard setting agencies categorised trade finance as a “higher risk” business for money laundering, terrorist 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
- More recently with the Covid 19 crisis, we have seen more issues in this space
- Trade Compliance currently a very manual task due to paper-based documentation – takes time and is human error-prone. Profit margins are challenged
- There are initiatives on digitisation of trade documentation which still requires more work and global interoperability for this to be successful
- National level initiatives by Singapore Customs on Networked Trade Platform (NTP) to make trade data available is a step forward

The Use of Technology in TBML / Financial Crime Compliance

FIs are facing a wide range of challenges in meeting their financial crime compliance-related regulatory requirements, namely: increasing costs, evolving money laundering techniques and new technologies for moving illicit funds. In order to mitigate against these impediments, FIs have recognised the importance of leveraging on growing digital footprints and employing the use of technology in FCC.



Moving Forward : Innovation and Use of Technology in Compliance – Example



A holistic view is important to manage customer risk / Work is Ongoing on Digitization of Trade and Better Approach to Combat TBML



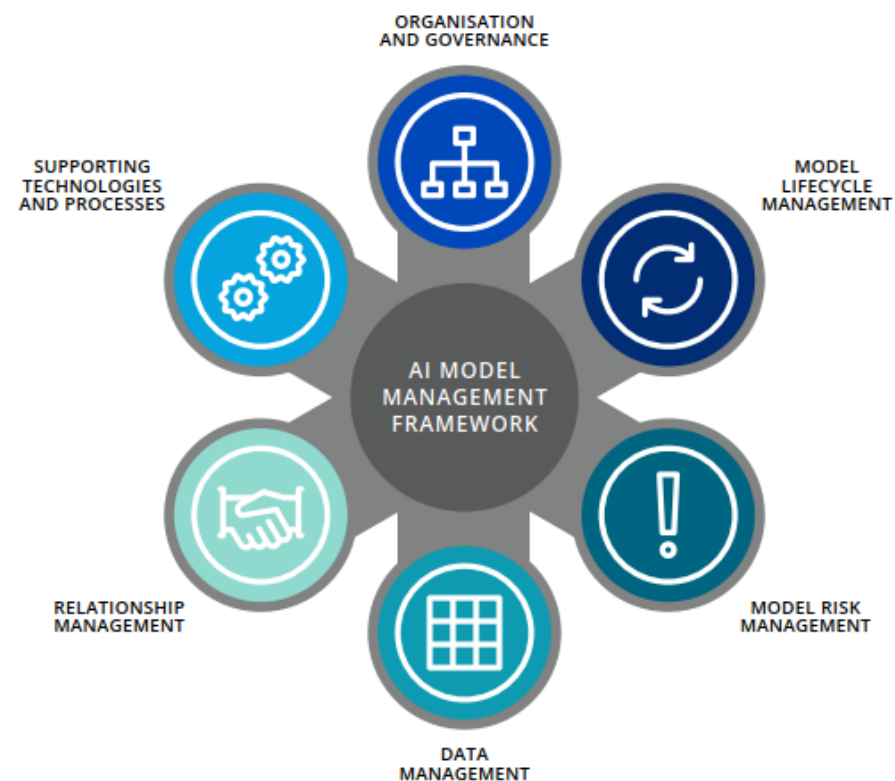
Moving Forward: Ensuring Responsible Use of Technology in FCC

As the use of technology evolves to include AI/ML, RPA and advanced data analytics, it is of paramount importance to ensure that such models are deployed responsibly

To provide a blueprint for responsible implementation of AI/ML and data analytics, the Monetary Authority of Singapore (MAS) has developed guiding principles, the FEAT guidelines, for practitioners' reference

<p>Fairness Justifiability and the accuracy / bias of business decisions driven by analytics</p>	<ul style="list-style-type: none"> Justifiability ensures that the use of models is impartial Individuals or groups should not be systematically disadvantaged Personal attributes should not be used as data inputs unless decisions can be justified.
<p>Ethics Adherence to ethical standards and code of conduct</p>	<ul style="list-style-type: none"> Use of model must be in line with an FI's ethical standards, values and code of conduct. Model-driven decisions are held to the same ethical standards as human decisions
<p>Accountability Clear responsibility and ownership of models, as well as model-driven decisions</p>	<ul style="list-style-type: none"> Internal Accountability: Use of the model for decision making must be approved by the appropriate internal authority. External Accountability: Enquiry channels should be available for submission of appeals and review requests for external stakeholders where applicable verified supplementary data should be considered when performing a review on model-driven decisions.
<p>Transparency Disclosing information associated with the model as part of general communication, or upon request</p>	<ul style="list-style-type: none"> The proactive disclosure of model use as part of general communications; The explanation on the data used to make decisions and how the data affects the decision Clear explanations to be provided upon request An appropriate balance in the level of transparency should be achieved. An avenue should be available to provide clear explanations about data used for decision making, and how the data affects the decision and the consequences on data subjects.

Incorporating the 4 elements of the FEAT principles, Deloitte developed a model management framework to ensure the responsible use of such technologies



Speaker's Profile

Radish Singh



Radish Singh

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SEA

Summary

Radish has over 23 years of experience in the field of financial services regulations, compliance, anti-bribery and corruption, conduct of business and financial crime (AML/ Sanctions). She currently leads Deloitte's South East Asia Financial Crime Compliance practice. Her clientele includes major global and local Banks in Singapore.

Broadly, her experience includes regulatory, business conduct policy formulation, legislative drafting, anti-money laundering, outsourcing, implementing anti-bribery and corruption policy, advising on data protection matters, establishing corporate governance codes, stock exchange supervision / rules and securities laws. Radish has been actively presenting on global regulatory reform as a result of the G20 initiatives to major banks and institutions in Singapore as well as in various public forums. She has led numerous assignments on other regulatory matters including data protection. Radish has also worked on commission rates setting and review of fee charged by regulators to sustain a self-funding model. She has in her previous role led an engagement with the Association of Banks in Singapore to revise and modernize their AML guidelines for the banking industry in Singapore. She has advised the Institute of Banking and Finance Singapore on revising their compliance and AML industry standards modules. She has also in her experience drafted corporate governance and code of ethics codes along with Board charters.

Radish has gained her experience from premier organizations such as PwC, Securities Commission Malaysia, Dubai Financial Services Authority, The Royal Bank of Scotland, HSBC, Dubai International Financial Centre Authority and DIFC Investments. Radish was an Executive Committee member of the Dubai International Financial Centre Authority and Data Protection Commissioner for Dubai International Financial Centre (based on the EU Data Privacy law). She has previously headed Compliance and Risk function and held a regional head role for KYC / CDD function for a major global bank. More recently Radish has been undertaking and leading numerous projects on financial crime including AML, sanctions and risk assessments for numerous global and regional banks (both investment and private banks) as well as training on conduct.

Academic Qualifications

- Bachelor of Laws (Hons) and Masters in Business Administration (Finance) (UK)

Recent Relevant Experience

- Established a regulatory research function covering key regulatory developments across Asia. Themes include the G20 regulatory reform agenda, extra-territorial regulations and key regulatory developments initiated by domestic regulations.
- Led a KYC project comprising 50 to 70 staff for a major private bank
- Leading enterprise wide AML risk and gap assessments for full banks and private banks – and establishing the risk assessment methodology
- Leading regulatory driven compliance framework, suitability and transactions look backs
- AML policy and framework review and enhancement for both private and investment banks
- Review of risk classification and tax evasion red flags for both private and investment banks
- Advising on trade finance and correspondent banking compliance issues
- Anti-bribery, conduct risk and AML training and compliance awareness
- Advising on various products and prospectuses relating to equity structured derivatives (both conventional and shariah based), issuance of debt instruments, review and recommendations for documentation and disclosures
- Led AML and sanctions related engagements with major / global banks including being seconded to a Global Bank in this area
- Overseeing extensive scope fraud investigations running over 2 years for a sovereign wealth fund

A few relevant papers

<https://www2.deloitte.com/sg/en/pages/financial-advisory/articles/the-case-for-artificial-intelligence-in-combating-money-laundering-and-terrorist-financing.html>

<https://www2.deloitte.com/sg/en/pages/financial-advisory/articles/financial-crime-compliance.html>

<https://www2.deloitte.com/sg/en/pages/financial-services/articles/tbml-compliance.html>

<https://abs.org.sg/docs/library/best-practices-for-counteracting-trade-based-money-laundering.pdf>

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