



**Asia/Pacific Group  
on Money Laundering**

ASIA/PACIFIC GROUP ON MONEY  
LAUNDERING

# **APG Typology Report on Trade Based Money Laundering**

**Adopted by APG Members at the 15th Annual  
Meeting**

**20 July 2012**

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## **EXECUTIVE SUMMARY**

### **EXECUTIVE SUMMARY**

1. Trade Based Money Laundering (TBML) was recognized by the Financial Action Task Force (FATF) in its landmark 2006 study as one of the three main methods by which criminal organizations and terrorist financiers move money for the purpose of disguising its origins and integrating it back into the formal economy. This method of money laundering (ML) is based upon abuse of trade transactions and their financing. The 2006 FATF Study highlighted the increasing attractiveness of TBML as a method for laundering funds, as controls on laundering of funds through misuse of the financial system (both formal and alternate) and through physical movement of cash (cash smuggling) become tighter.
2. In recent years APG members have continued to highlight vulnerabilities for TBML, but very few cases investigations or prosecutions appear to have been undertaken in the Asia/Pacific region and very few case studies had been shared.
3. The APG's TBML study aims to build on the existing studies, in particular those of the FATF, in order to study the extent of the prevalence of TBML and highlight current methods, techniques and modus operandi for TBML as well as to identify 'red flags' to detect and respond to TBML.
4. In determining the magnitude of TBML, the study considered why so few cases of TBML have been detected since the FATF's 2006 study. The Paper has sought to clarify and furnish explanations for terms and processes of 'trade finance' which are comprehensible to Money Laundering (ML) investigators.
5. This Paper has focused on TBML occurring in the course of international trade in goods. The study does not include in its scope capital flight, tax evasion, trade in services and domestic trade. The features of the dynamic environment that distinguish TBML from other forms of ML are its occurrence through intermingling of the trade sector with the trade finance sector in cross- border transactions. The foreign exchange market and the long supply chain make international trade particularly vulnerable to TBML.
6. The study included circulation of a questionnaire to APG and FATF members seeking statistically significant indicators. The Paper sets out a number of Case Studies to illustrate trends of TBML. Simplified explanations of the terms and processes of trade finance have been attempted through interaction with the private sector. A brief review of the literature on the subject generated by the FATF, FSRBs and other authors has been made.
7. There is a growing concern on how the rapid growth in the global economy has made international trade an increasingly attractive avenue to move illicit funds through financial transactions associated with the trade in goods and services. TBML is a complex phenomenon since its constituent elements cut across not only sectoral boundaries but also national borders. The dynamic environment of international trade allows TBML to take multiple forms.

## KEY FINDINGS

8. Statistical analysis has been conducted on the basis of responses received on 64 questions from 19 jurisdictions and 1 organisation.
9. Few TBML cases have been reported. The extent of TBML in the region was not able to be accurately estimated in this study. However, during the course of the study it has become evident that TBML is a problem for many of the participating jurisdictions and has serious significance as an avenue to launder proceeds of crime.
10. There is lack of awareness and training on TBML among the jurisdictions. Training for those responsible for detection and investigation of TBML as well as to those who collect trade data and handle trade finance is critical to raise their awareness about TBML and build capacity to identify TBML.
11. Most jurisdictions do not distinguish TBML from other forms of ML. A major obstacle in devising strategies to tackle TBML has been the lack of reliable statistics relating to it. There is presently no standardization with regard to the practice of collection and maintenance of data on TBML. Trade related data is collected to serve purposes other than those of detecting TBML.
12. The lack of TBML investigators and absence of systems capable of cross-referencing trade and trade finance data are significant limitations. In most of the reporting jurisdictions customs authorities or equivalent collect and manage trade data but do not have the authority to conduct ML investigation.
13. Over 50% of the reporting jurisdictions indicate referrals from other agencies which trigger TBML investigations. Again, over 50% of the reporting jurisdictions seek information from international counterparts. However there are impediments in domestic coordination and international cooperation among the competent authorities. The main impediments which have been identified are requirement of maintaining confidentiality, delays in response and conveying of information with restrictions.
14. Reporting jurisdictions have listed a large number of patterns and red flags which this Paper has categorised in five broad groups viz. Trade Finance, Jurisdictions, Goods, Corporate Structure and Predicate Offences. The last four categories have been dealt with in the past papers under the broad category of trade. With regard to trade finance the important red flags relate to methods of payment and letters of credit. Existence of duty free zones and prevalence of high duty structure can make jurisdictions sensitive to TBML. The discrepancy about description, quality, quantity and value of the goods which are traded can be important red flags. Front or shell companies are often used as corporate structures to facilitate TBML. Tax evasion and customs offences are important predicate offences for TBML.
15. The trade finance products identified in this study reveal a menu of choices that are available to genuine traders to facilitate trade. Exporters and importers enter into an agreement to trade more often than not by way of cash payment or through some more

complex form of trade financing. Such trade finance products include bills of exchange, counter trade, letters of credit and open account facilities. A range of open account facilities may encompass factoring, forfaiting and other forms of credit. While the trade finance products were innovated to reduce trade transaction costs, their accessibility have also made them vulnerable to TBML abuse. Thus the trade in commodity has become as good as means of movement of cash and of transfer of funds to indulge in laundering.

16. Financial sector representatives indicate a trend toward the use of open account financing in trade. This has implications for detecting the abuse of trade finance for ML.
17. The case studies included in the Paper, besides identifying the elements of trade that facilitate TBML, also bring out the mechanisms of trade finance used in TBML. One case study highlights the financing of different segments of trade through diverse mechanisms of trade finance that can introduce risks in the trade transactions which are difficult to assess by financial institutions. The mechanisms of financing trade through factoring and through disbursement of trade credit to overseas suppliers are fraught with risks for financial institutions unless due diligence is exercised over the overseas trading partner, are brought out in another case study. Another case study shows how the operations of 'exchange houses' owned and controlled by criminals coupled with 'compromised' working of a bank make trade finance mechanisms means for indulging in TBML. There are other case studies which demonstrate the use of alternative remittance systems and of corporate structures to facilitate TBML. A final case study shows multiple forms of international trade and various mechanisms of trade finance which give inherent flexibility to criminals to adopt those forms and types which suit the demands of a situation.
18. The 2006 FATF Paper on TBML focused on trade based techniques used in TBML, which have been mentioned as over/under invoicing of goods, multiple invoicing of goods, over/under shipments of goods and false description of goods. These techniques need to combine with techniques which abuse trade finance mechanism, for TBML to occur. Four of these techniques have been identified in this paper as cash inflow based payment, third party payment, segmental modes of payment and alternative remittance payment.

## **POLICY OBSERVATIONS**

19. Any strategy to prevent and combat TBML needs to be based on dismantling TBML structures while allowing genuine trade to occur unfettered. An emphasis on inter-agency coordination and international cooperation, needs to be adopted by policy-makers. A comprehensive strategy which takes into account sectoral peculiarities, agency specialization and jurisdictional frameworks can only address the challenges in tackling TBML.
20. There is a need to have common formatting for recording and maintaining trade-relevant statistics so that data sets can be analysed to identify trends related to TBML. Cross-referencing of data relating to trade and trade finance can be the starting point for adopting a risk based approach to identifying TBML. There is an acute need to correlate trade data

with the foreign exchange data to detect TBML and identify cases where value is in the form of goods without corresponding outgo of foreign exchange as payment.

21. Multiple agencies are involved either directly or indirectly in combating TBML. Levels of specialization in mandated roles to combat TBML varies. However, the strategy to prevent and combat TBML requires expertise created through the combination of all such authorities. One way-forward to combine the respective competencies of relevant authorities for combating TBML is to form domestic task-forces. Task-forces focused on TBML investigations will need to have the ability to utilize the expertise of each agency without compromising its functional skills.
22. There is an urgent need to strengthen the existing bilateral arrangements like Trade Transparency Units (TTUs) and to build multilateral mechanisms for international cooperation. The bilateral arrangements must ensure prompt exchange of information with regular follow-ups which should result in more efficient delivery. The multilateral mechanisms may entail equal commitment of all trading jurisdictions for coordination in matters relating to TBML.
23. TBML focused training is an absolute necessity for the anti-TBML strategy to succeed. Customs, ML investigating LEA, FIU, Tax Authorities and Regulators have all identified a pressing need for more focused training so that their personnel can have an adequate knowledge base to detect, prevent and combat TBML. The sharper focus on TBML in existing training programs can be brought about by incorporating specific topics which relate to TBML. The case studies, the red flags and typology papers on TBML may be disseminated during such programs. As trade essentially involves multiple jurisdictions, there is a need for Law Enforcement Officers to understand the legal and procedural aspects of other jurisdictions. Training should be aimed at making use of trade data analysis as well as cross referencing trade data with trade finance data and understanding any useful tools developed to identify trade anomalies which may lead to investigation and prosecution of TBML cases. Inter-linkages of tax frauds and customs violations with TBML also need to be explained.

## **CHAPTER I - SCOPE & COVERAGE**

### **INTRODUCTION**

24. The Asia/Pacific Group on Money Laundering (APG) produces regional typologies studies of money laundering (ML) and terrorist financing (TF) in the Asia/Pacific region. This is done to share information and support a better understanding of ML and TF methods, techniques and trends in the region.
25. Typologies of ML and TF allow Governments and the private sector to understand the nature of the ML and TF environment and design effective AML/CFT strategies to address threats. Typologies help APG members to implement effective strategies to investigate and prosecute ML and TF, as well as design and implement effective preventative measures.
26. Trade Based Money Laundering (TBML) has been recognized by the Financial Action Task Force (FATF) in its landmark study published in 2006, as one of the three main methods by which criminal organizations and terrorist financiers move money for the purpose of disguising its origins and integrating it back into the formal economy. This method of ML is based upon abuse of trade transactions and their financing. The FATF Study 2006 highlighted the increasing attractiveness of TBML as a method for laundering funds, compared with misuse of the financial system (both formal and alternate) and through physical movement of cash (cash smuggling).
27. The revision of FATF standards undertaken in 2003 entailed stricter controls on the financial system and on cash couriers, which may have had an unintended consequence of leaving the trade finance sector more vulnerable to ML and TF. The increasing volume, speed and value of global trade and the complexities inherent in trade transactions and in its financing arrangements coupled with limited awareness and understanding of how such trade can be abused, have made TBML an important avenue for moving illicit funds.

### **AIMS OF THE STUDY**

28. The APG Annual Meeting in Kochi, India in July 2011 resolved to take-up further study on TBML as an APG Typology Study. The Study commenced with the following aims:
  - i) to build on the existing studies and in particular that of FATF published in 2006;
  - ii) to study the extent of the prevalence of TBML;
  - iii) to highlight current methods, techniques and modus operandi for TBML so as to short list 'red flags' to detect and respond to TBML; and
  - iv) to clarify and furnish explanations for terms and processes of 'trade finance' which are comprehensible to ML investigators.



## SCOPE OF THE STUDY

29. It is useful to consider the fundamental elements of trade in goods that this study will consider when discussing TBML. Conceptually, trade can be broken into various elements which may be overlapping:
- arrangements to trade goods
  - financial steps to facilitate the trade (financing, insurance, etc.)
  - movement of goods
  - reconciliation or settlement of financial accounts
30. TBML was defined by the FATF in 2006 as ‘the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origins.’ The FATF Paper on Best Practices (2008) broadened the definition by stating, “TBML and terrorist financing (TBML/FT) refer to the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illegal origin or finance their activities.” Such broadening of the definition, allows for illegal activities such as terrorist financing to be covered within the scope of TBML.
31. The FATF Study of 2006 excludes the coverage of the movement of money for tax avoidance, evasion and capital flight, on the grounds that such movement of funds usually involves transfer of legitimately earned funds across borders while TBML involves the ‘proceeds of’ or ‘instruments of’ crime. However, the FATF 2008, Paper on Best Practices does cover within the definition of TBML, the movement of licit funds for the purpose of illegal activities such as terrorist financing. This broadening of the definition, coupled with the intermingling of licit and illicit funds imply that the abuse of capital flight and the movement of funds for tax avoidance / evasion are within the scope of TBML.
32. This paper excludes consideration of domestic trade in its study of TBML. While the FATF definitions of TBML do not exclude domestic trade from their ambit, the framework chosen by this and other papers leaves domestic trade out of scope. This is not to deny that TBML can occur through domestic trade, however given that domestic trade is less regulated and large in terms of number of transactions, the time resource available to compile this Paper and the amount of ‘noise’ that exists in the domestic market does not allow for its coverage.
33. Whilst the definition of TBML being considered includes international trade in ‘services’ which has also been addressed in previous FATF Papers, trade in services and other intangibles is also out of scope of this Paper. The lack of standardization of the definition of ‘services’ and difficulties in estimating the ‘fair value’ of their provision, will not allow for its meaningful treatment in the present study. The project team believes that separate studies devoted to trade in services and other intangibles, keeping their peculiarities in view, are called for. The implications of the capital flight and the movement of funds for tax evasion for TBML need to be examined separately. Mechanisms like transfer pricing are still largely in the domain of taxation. Therefore the present Paper while adopting the

definition of TBML given by the Best Practices Paper 2008 of FATF does not include in its scope capital flight, tax evasion, trade in services and domestic trade.

34. The rapid expansion of global trade has increased the possibilities for TBML. Trade is the 'engine of growth' and ensures optimal use of resources. Thus the need to have a 'free and fair' trade regime has been emphasized. The dilemma which is faced by policy makers is the requirement to balance the needs of a free, fair and predictable trade regime with the needs for regulation of trade so as to prevent its abuse. Total Global Merchandise Trade stood in 2010 at US \$ 30.729 Trillion {US \$ 15.237 Trillion exports + US \$ 15.492 Trillion imports}<sup>1</sup> which indicates the potential for absorption and movement of funds of criminal origin through international trade and the need to study TBML.
35. One common thread running through studies of the FATF, of FATF-style regional bodies (FSRBs) such as the APG, and other literature is acknowledgement of the lack of awareness of TBML. Such studies have consistently highlighted difficulties in detecting TBML cases. A lack of understanding of those features of TBML that are distinct from other forms of ML is viewed as one reason for a lack of TBML cases. While acknowledging the commonalities between TBML and other forms of ML, attempts have been made in this Paper to identify a few distinguishing features of TBML. Recognition of such features may help develop better 'red flags', support increased awareness and lead to more detections.
36. Distinguishing features of the dynamic environment for TBML include:
  - a) TBML using international trade occurs over more than one jurisdiction, while other forms of ML may be only of a singular jurisdiction. **Cross border transactions** provide opportunities to take advantage of differences in legal systems of various jurisdictions. A jurisdiction may have less restrictive Customs checks (Free Trade Zones) and less stringent AML set-up than trading partner. The high volume, regularity and speed of international trade increase vulnerabilities.
  - b) TBML necessarily requires **intermingling of the trade sector with the finance sector**. Criminals take advantage of vulnerabilities of both the sectors. Merely having an AML regime for the finance sector becomes inadequate unless such a regime effectively covers the corresponding trade sector. Moreover, cross-referencing of trade-data, with that of trade finance becomes essential when investigating TBML.
  - c) International trade is denominated in terms of internationally acceptable currencies. Trade becomes exposed to the **vulnerabilities of the foreign exchange market**. The conversion of currency at market determined exchange rates enhance the scope for criminals to launder the proceeds of or instruments of crime.
  - d) The **long supply chain** necessary for international trade make the trade more vulnerable to TBML. This chain of manufacturer, trader, consigner, consignee, notifying party, financier,

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<sup>1</sup> Source: (<http://stat.wto.org/StatisticalProgram/WSDBViewData.aspx?Language=E>)

shipper, insurer and freight forwarder broaden the scope for abuse of the system by the criminals because of all the vulnerabilities that exist.

## **METHODOLOGY**

37. The Methodology which has been adopted in this Paper has the following important elements:-

- a) A Questionnaire was prepared and circulated among the jurisdictions for completion by relevant agencies (see Annex B). A statistical profile was drawn from responses to the questionnaire. However responses were received from only limited number of jurisdictions which has resulted in making the size of the sample small. Results based on a sample of small size may not be regarded as statistically significant. Nevertheless, the statistical responses have brought the project team to the conclusion that there are commonalities amongst various jurisdictions with regard to the challenges in understanding and tackling TBML.
- b) Case studies were sought as part of the questionnaire. APG members' Typology Status Reports from previous year were examined for cases and other reference materials. A limited number of case studies were reported. Those case studies have been used to appreciate the recent trends of the modus-operandi and techniques adopted for TBML as well as to develop 'red flags'.
- c) Terms and 'processes of trade finance' have been examined and simplified explanations have been attempted so as to make these comprehensible for investigators. This is considered an important feature of this study as TBML is a complex subject and lawmakers and investigators alike find it difficult to understand the terms and processes of international trade and its financing arrangements. In this regard the Project Team interacted with the private sector.
- d) A brief review of some of the literature on the subject has been made. Existing studies on the subject made by the FATF, FSRBs and other organizations have been examined in an attempt to take this body of research forward.

## **FRAMEWORK**

38. Chapter II of this paper considers issues categorized into four areas of concern.

- (i) What is the extent of TBML in specific jurisdictions, regions and across the globe?
- (ii) What should be the roles, responsibilities of investigating agencies and other allied agencies to tackle TBML?
- (iii) What are the best practices (preventative measures) to effectively deal with TBML?  
and
- (iv) What are those features of TBML which can make it possible to discern it from other forms of ML?

39. The inferences drawn from the statistical analysis of the responses received to the Questionnaire attempt to provide answers to these concerns. The statistical analysis made in Chapter-II has also looked at the extent of the prevalence of TBML.
40. Chapter III of this Paper aims to develop a simplified explanation of terms and processes of trade finance so as to make these comprehensible for investigators. Improved understanding of concepts, terms and processes of trade finance should assist AML investigators to detect TBML cases by cross-referencing the leads from trade transactions with those of trade finance.
41. Chapter IV of this Paper illustrates the techniques of TBML through case studies. The Chapter elucidates how the abuse of trade system combines with that of trade finance for TBML to occur. Techniques of Trade Finance abuse have been identified. Chapter-V of this Paper is devoted to drawing of conclusions and suggesting way forward.

## **REVIEW OF EXISTING STUDIES**

42. In order to better understand the complex subject of TBML, this Paper seeks to review the existing literature on TBML. This includes studies by published by the FATF, FATF-style regional bodies (FSRBs) and a range of studies from intergovernmental organisations, jurisdictions, the academic sector and other bodies.

### **Financial Action Task Force (FATF) Studies**

#### ***Trade Based Money Laundering (2006)*<sup>2</sup>**

43. The FATF TBML study of 2006 set out a number of key findings and recommendations:-
  - a) TBML is a complex and increasingly important channel of ML.
  - b) Techniques of TBML adopted by criminals vary from simple to complex. Simple techniques include ‘over/under invoicing’ of goods, multiple invoicing of goods, ‘over/under shipments’ of goods and falsely described goods. Combinations of several simple techniques have been regarded as complex.
  - c) Analysis of trade data and its international sharing are useful tools for identifying trade anomalies and detection of TBML. Since international trade leaves behind documentation, the anomalies noticed during data analysis may lead the investigator to documentary evidence. Lack of structured and regular exchange of information related to trade and trade finance among relevant agencies.
  - d) The lack of resources and training further constrain Customs, LEA, FIU and Tax Authorities to develop effective AML methodologies against TBML.

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<sup>2</sup> <http://www.fatf-gafi.org/dataoecd/60/25/37038272.pdf>

44. The FATF 2006 study identified and recommended three main areas to be focused by Authorities to increase effectiveness in combating TBML:
- i) Building better awareness among the agencies responsible for detection, investigation and prosecution of offenders involved in TBML. These agencies have expressed strong need for training.
  - ii) Strengthening current measures so that there is extensive use of the available material in the form of case studies and red flag indicators of TBML. The aspects of effective domestic cooperation and sharing of information among Law Enforcement Agencies and Regulators have also been impressed upon.
  - iii) Improving international cooperation so that it can act as a trigger for detection of TBML cases. In this regard the setting up of physical and legal infrastructure has been emphasized.

***Best Practices Paper on Trade Based Money Laundering (2008)***<sup>3</sup>

45. The FATF Best Practices Paper on TBML (2008) has provided important guidelines for detection and investigation of cases of TBML. The objective of the Best Practices Paper was to improve the ability of competent authorities to collect and effectively utilise trade data, both domestically and internationally, for the purpose of detecting and investigating ML and TF through the trade system. It was also aimed at FATF continuing to explore vulnerabilities in the trade system, including those related to trade finance, with a view to identifying other measures that could be considered in combating illicit use of the trade system.
46. The best practices described include:
- a) Capacity building and increased awareness of TBML to be achieved by enhancing the focus on TBML in training programs. Developing capacity to identify anomalies in data collected for trade transactions and in trade finance.
  - b) Familiarize staff of competent authorities with typologies & ‘red flags’ and include these in their training materials & internal guidance manuals. A Risk based approach with target orientation has been strongly recommended.
  - c) Cooperation among domestic competent authorities to be developed so as to facilitate coordination between authorities responsible for collecting and analysing trade data and the authorities responsible for investigating ML and TF. For this purpose, jurisdictions should identify where trade data and trade finance data are being stored and managed. Often such data is dispersed over more than one agency.

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<sup>3</sup> <http://www.fatf-gafi.org/media/fatf/documents/recommendations/BPP%20Trade%20Based%20Money%20Laundering%202012%20COVER.pdf>

- d) Investigation Agencies should have timely and clear access to trade data and trade finance databases, through secure networks and Memoranda of Understanding.
  - e) Practical obstacles in the area of domestic cooperation and information sharing to combat TBML/FT need to be identified and addressed. Specific best practices involving information sharing between domestic agencies and FIU were also suggested. It has been recommended that FIU should be able to obtain information from agencies collecting trade data viz. Customs and Trade Authorities.
  - f) Encourage international cooperation to provide the widest possible range of mutual legal assistance in TBML/FT investigations and prosecutions. Clear and effective mechanisms and gateways need to be established to facilitate trade data.
47. The Best Practices Paper has recommended safeguards relating to maintenance of data protection and privacy as well as to ensure competitive neutrality for legitimate trading activities which is also supported by the project team.

***Money Laundering Vulnerabilities of Free Trade Zones (2010)<sup>4</sup>***

- 48. The 2010 FATF study on Free Trade Zones (FTZs) has significant cross-over with earlier studies on TBML and includes three case studies of TBML. One of these cases relates to TBML for terrorist financing (Hezbollah).
- 49. Businesses located in FTZs utilise international trade for a majority of transactions. FTZs are designated areas within jurisdictions in which incentives are offered to support the development of exports, foreign direct investment (FDI), and local employment. These incentives include exemptions from duty and taxes, simplified administrative procedures, and the duty free importation of raw materials, machinery, parts and equipment. In addition to boosting economic opportunity, these incentives can result in a reduction in finance and trade controls and enforcement, creating opportunities for ML and TF.
- 50. The lack of AML/CFT safeguards poses a particular vulnerability in FTZs. Cases in the FATF report highlight systematic weaknesses that make FTZs vulnerable to abuse including relaxed oversight, lack of transparency, absence of trade data and systems integration.
- 51. The study finds that FTZs may facilitate the TBML and related illicit activity. The misuse of FTZs impacts every jurisdiction in the world, regardless of whether or not a jurisdiction has FTZs.

***FATF Typologies on Proliferation Financing (2008)***

- 52. The June 2008 FATF Typologies Paper on Financing the Proliferation of Weapons of Mass Destruction<sup>5</sup> did not address TBML directly, but did include an annex on trade

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<sup>4</sup> [http://www.fatf-afi.org/media/fatf/documents/reports/ML%20vulnerabilities %20of%20Free%20 Trade% 20Zones .pdf](http://www.fatf-afi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf)

documentation, including those relevant to trade finance. These descriptions have been included as part of the Chapter on Trade Finance.

## **EAG**

53. The Eurasian Group (EAG) on Combating ML and TF has published two reports relating to TBML. These are as follows:

*(i) EAG Working Group on Typologies Study Report on "International Trade Based Money Laundering" (December, 2009)*<sup>6</sup>

54. The EAG Study Report on International TBML was based on the generalized findings of national studies conducted by select EAG members. The study considered the use of foreign trade transactions to launder proceeds and instruments of crime. The EAG study focused on identifying the legal aspects of business regulation that affect the development of various mechanisms using both international economic and especially, trade-based, activities for ML. An attempt was made to analyse the legal standards of national legislations governing the conduct and control of foreign trade-based transactions.

55. This Study highlighted instruments, mechanisms and corporate structures, used for TBML. Instruments such as fictitious export/import transactions and false contracts were identified. Common mechanisms used for the purpose have been found as non-declaration / mis-declaration of goods and false certificate of origin. Corporate structures involved in the process comprise three groups of entities viz. transient firms, off-shore companies and illegal financial services providers.

*(ii) EAG Typology Report on Risks of Money Laundering in Foreign Trade Transactions (December, 2010)*<sup>7</sup>

56. The EAG Report on the Risks of Money Laundering in Foreign Trade Transactions aimed to develop a risk assessment methodology to prevent and combat use of foreign trade transactions in ML schemes.

57. The main features of the study were: the identification of legal aspects in Foreign Trade Regulation; efficient assessment of the risk based approach in national AML strategies; and, the analysis of monitoring mechanisms adopted by financial institutions. The study attempted to classify ML risks in foreign trade transactions by determining the share therein of risk companies, risk countries and risk commodities. All competent authorities, including, policy makers, customs, taxation authorities, central bank and financial institutions were called to adopt risk assessment approach.

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<sup>5</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Typologies%20Report%20on%20Proliferation%20Financing.pdf>

<sup>6</sup> [http://www.eurasiangroup.org/typology\\_reports.php](http://www.eurasiangroup.org/typology_reports.php)

<sup>7</sup> [http://www.eurasiangroup.org/ru/news/WGTYP\\_2010\\_6\\_eng.pdf](http://www.eurasiangroup.org/ru/news/WGTYP_2010_6_eng.pdf)

## APG

58. The 2008 APG Typologies Report<sup>8</sup> collected case studies from across the Asia/Pacific region and included case studies on TBML and related cases. Case studies on alternative remittance services, shell companies, off-shore banks and promissory notes are of significance to the current research.
59. The 2012 APG Typologies Report includes a number of TBML case studies from across the Asia/Pacific region.

## The Wolfsberg Group

60. The Wolfsberg Group is an association of eleven global banks formed in 2000 to develop financial services industry standards. In 2009 the Wolfsberg Group published a paper entitled The Wolfsberg Trade Finance Principles<sup>9</sup>, which aimed to contribute to industry efforts to define standards for the control of the AML/CFT risks associated with trade finance activities. The Wolfsberg Group published these Principles on the role of Financial Institutions (FIs) in relation to the management of processes: 1) To address the risks of ML and terrorist financing through certain trade finance products, and 2) To aid compliance with international and national sanctions, including the Non Proliferation of Weapons of Mass Destruction requirements of the United Nations.
61. The paper addresses the mechanisms used for the finance of the movement of goods or services across international boundaries. In particular, the paper provides detailed, practical guidance on the types of controls that may be applied to letters of credit (LCs); documentary bills for collection (BCs); and sanctions, including non proliferation, weapons of mass destruction and dual use goods (NP WMD)
62. In 2011 an expanded version of the paper was published<sup>10</sup>. This version provides additional AML guidance in relation to guarantees (Gtees); standby letters of credit (SBLCs); and open account trade transactions. it is noted:

“Despite the fact that historically trade finance has not been viewed as high risk it has always been recognised that international trade and the processes and systems that support it are vulnerable to abuse for the purposes of ML and terrorist financing. In recent years, however, the focus on these risks has increased for a variety of reasons, including the dramatic growth in world trade. In addition, the fact that controls introduced by FIs in response to the more traditional ML techniques have become more robust means that other methods to transmit funds, including the use of trade finance products, may become more attractive to criminals.” (2011: 3)
63. The Wolfsberg Group noted that it is committed to the application of appropriate systems and controls in respect of trade finance products to mitigate these risks. It does not however

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<sup>8</sup> [http://www.apgml.org/documents/docs/6/APG\\_2008\\_Typologies\\_Rpt\\_July08.pdf](http://www.apgml.org/documents/docs/6/APG_2008_Typologies_Rpt_July08.pdf)

<sup>9</sup> [http://www.wolfsberg-principles.com/pdf/Wolfsberg\\_Trade\\_Principles\\_Paper\\_I\\_\(2009\).pdf](http://www.wolfsberg-principles.com/pdf/Wolfsberg_Trade_Principles_Paper_I_(2009).pdf)

<sup>10</sup> [http://www.wolfsberg-principles.com/pdf/Wolfsberg\\_Trade\\_Principles\\_Paper\\_II\\_\(2011\).pdf](http://www.wolfsberg-principles.com/pdf/Wolfsberg_Trade_Principles_Paper_II_(2011).pdf)



believe that currently there is sufficient evidence to support an assessment of this area as high risk for AML/Sanctions purposes. Despite this, the Wolfsberg Group calls for on-going cooperation between stakeholders to counter the threat of ML in the trade finance area.

## **United Nations Office of Drugs and Crime (UNODC)**

### ***Risk of Money Laundering through Financial Instruments, Users and Employees of Financial Institutions (2010)***<sup>11</sup>

64. The UNODC Risk of Money Laundering through Financial Instruments, Users and Employees of Financial Institutions (2010 English version) was produced to address the need of the justice sector to improve their economic, financial and accounting preparation in order to investigate, prosecute and adjudicate ML cases. The report does not specifically address TBML, but contains a brief description of various financial instruments, including a number of trade instruments, as well as their underlying documentation and red flags (451 in total).
65. Chapter 8 deals with Foreign Trade Business. It is noted that “Payments resulting from foreign trade business, understood to be the export or import of goods or services, can be one of the financial instruments at the highest risk for ML operations.” (2010: 113). Documents of interest (e.g. the import or export declaration or form, the interbank transfer of funds, and the declaration or form for registering the exchange operation) are identified. Warning signs regarding the transfer of funds resulting from foreign trade are also listed.

## **United States**

66. The Financial Crimes Enforcement Network (FinCEN) issued an advisory in 201012 to inform and assist the financial industry in reporting suspected instances of TBML. This advisory contained examples of ‘red flags’ based on activity observed in Suspicious Activity Reports (SARs) that may indicate TBML. Financial institutions were advised to take appropriate measures to mitigate the risks of analogous activity occurring globally.
67. It was concluded in that advisory that no one activity by itself is a clear indication of TBML. Due to some similarities with legitimate financial activities, financial institutions should evaluate indicators of potential trade-based money laundering in combination with other ‘red flags’ and expected transaction activity for its customer before making determinations of suspicion. Additional investigation and analysis may be necessary to determine if the activity is suspicious, based on information available to the financial institution.

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<sup>11</sup> <http://www.unrol.org/doc.aspx?d=3041>

<sup>12</sup> [http://www.fincen.gov/statutes\\_regs/guidance/pdf/fin-2010-a001.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2010-a001.pdf)

## Journal Articles

### *Delston R S & Walls SC (2009) Reaching Beyond Banks: How to Target Trade-Based Money Laundering and Terrorist Financing Outside The Financial Sector.*

68. Delston and Walls in their publication (Delston R S & Walls SC 2009) *Reaching Beyond Banks: How to Target Trade-Based Money Laundering and Terrorist Financing Outside The Financial Sector*. *Case Western Reserve Journal of International Law* 41 (8): 85–118) have stated that AML/CFT measures have succeeded in restricting the two traditional avenues of ML, namely, the abuse of financial intermediaries and the physical movement of money across borders. Consequently, international criminal and terrorist organizations have turned to TBML to conceal and legitimize their funds, as this is a channel that remains relatively untouched by AML/CFT efforts internationally.
69. The authors noted the FATF's focus on TBML due to ML and TF risks as well as financing of the proliferation of weapons of mass destruction (WMDs). The paper proposed a far-reaching solution—that those in the international supply chain be required by law to adopt AML/CFT safeguards to protect their businesses, including filing suspicious activity reports, identifying their customers, and designating an AML/CFT compliance officer.
70. Delston and Walls (2009), argued that there needs to be greater harmonisation between the FATF Best Practices Paper for combating TBML and the 2003 FATF Recommendations calling for traders to adopt CDD, KYC and STR reporting protocols in line with obligations on financial institutions and DNFBPs. Their proposals appear to be at odds with the recommendations put forward in the FATF *Best Practices Paper*, which cautioned against undue regulatory burdens upon legitimate trading activities. However, Delston & Walls warn that 'companies may ignore their TBML risk only at their peril' (Delston & Walls 2009: 118) and suggest that businesses may voluntarily go beyond FATF's Best Practices to safeguard themselves against TBML threats.

### *Zdanowicz JS 2009, Trade-Based Money Laundering and Terrorist Financing*

71. Zdanowicz (Zdanowicz JS 2009, *Trade-Based Money Laundering and Terrorist Financing*. *Review of Law and Economics* 5(2): 858–878) contributes to the literature on TBML and terrorist financing by providing an analysis of previously unused statistical techniques and methodologies as a means of monitoring, detecting and prosecuting ML activities. Zdanowicz describes how new statistical profiling methodologies that evaluate transactions contained in a jurisdiction's international trade database can mitigate the risks associated with TBML.
72. Zdanowicz discusses the application of four new TBML profiling techniques which focus on jurisdiction, customs district, product, and transaction price risk characteristics. The paper highlights recent developments which reveal a new focus on TBML and TF.
  1. Trade Transparency Units:
  2. FATF: Trade-Based Money Laundering Report: In June 2006

### 3. FFIEC Bank Secrecy Act Anti-Money Laundering Examination Manual

#### ***Brown HA 2009, Free Trade Zones: Haven for Money Laundering and Terrorist Financing?***

73. Brown has raised several possible vulnerabilities associated with the area of FTZs (Brown HA 2009, Free Trade Zones: Haven for Money Laundering and Terrorist Financing? ACAMS Today January: 10–12) that include:
- i) Possible lack of regulations or lack of enforcement of regulations within free trade zones;
  - ii) use of cash or nonfinancial instruments, which are usually high risk, as the primary forms of payment that occur within these zones;
  - iii) lack of means to implement, enforce or create regulations needed within free trade zones;
  - iv) difficulties in determining the primary owner of the goods or the point of origin of the shipments due to the transference of many shipments into and out of multiple free trade zones around the world;
  - v) due to the beneficial tax incentives offered within these areas, and the decrease or lack of tax revenue gathered by customs officials, there is little incentive to enforce or implement regulations and oversee trade;
  - vi) the lack of automation and an accurate method of recording shipments and items manufactured or received within many free trade zones, causing the loss of a paper trail that can accurately verify the true owner of the goods;
  - vii) possible zone manipulation to aid in trade-based money laundering, including over-and-under invoicing, *hawalas* and Black Market Peso Exchange, among other trade based schemes.
74. Various best practices and recommendations, as mentioned in this paper could increase the security, regulations and enforcement within these areas that currently do not have the measures in place to monitor or detect illegal activities.

#### ***McSkimming S 2010, Trade Based Money Laundering: Responding to an Emerging Threat.***

75. McSkimming (McSkimming S 2010, Trade Based Money Laundering: Responding to an Emerging Threat. Deakin Law Review 15(1): 37–63) observes that while little has been done to prevent trade-based financial crime, there is also little empirical evidence of its ill effect. Further, there has been little consideration as to whether systematic monitoring of the trade system would be cost-effective, relative to the number of offenders detected and the harm prevented. Without such analysis, it is almost impossible to reach a measured and balanced view on appropriate policy settings.
76. When considering typologies of over and under invoicing, McSkimming briefly considers issues of transfer pricing manipulation. A transfer price is the price paid for an exchange of goods and services between related affiliates of the same transnational corporation. This may be a parent firm trading with subsidiaries or between subsidiaries of the same firm. Transfer pricing refers to the method transnational corporations adopt for the setting and adjusting prices of goods or services from one associate of the entity to another associate within that same entity. Corporate subsidiaries in different countries must adjust prices

when one subsidiary transfers goods or services to a subsidiary operating in a different country. It is estimated that trade between related transnational corporations affiliates account for 60% cent of global trade, which represents significant risks for transfer mispricing.<sup>13</sup> Tax authorities require that an ‘arm’s length principle’ should be followed in determining the open-market price. Many markets are thin and often dominated by the same multinationals and market prices are hard to determine. Transfer pricing frauds ignore the arm’s length principle and misprice transactions to allow companies to move profits to low tax jurisdictions to minimise or avoid tax.

77. McSkimming proposes that even if monitoring were to be implemented, the analytical methodologies that are currently used have major flaws. They not only rely on data that is often of poor quality, but may also be worryingly easy to circumvent. This too, raises serious questions about the effectiveness of the proposed policy responses to TBML. The difficulties associated with data monitoring also raise the spectre of a significant increase in the number of physical, and therefore costly, inspections of trade goods. Preventing TBML/TF will take more than importing AML/CFT strategies from the financial sector to the trade sector. Instead, a robust new approach to AML/CFT in the trade sector will be required.
78. The author highlights that the absence of data on TBML/TF is particularly concerning in light of the fact that TBML/TF is a credible substitute for traditional, financial system ML typologies. If offenders are able to avoid AML/CFT controls by abusing the trade system in substantial numbers, then costly regulation of the financial sector may be pointless. McSkimming notes that the larger, organised crime syndicates most able to take advantage of TBML/TF, which makes the lack of effective AML/CFT responses even more concerning.

***Liao J & Acharya A 2011. Trans-shipment and Trade-Based Money Laundering***

79. Liao and Acharya (Liao J & Acharya A 2011. Trans-shipment and Trade-Based Money Laundering. *Journal of Money Laundering Control* 14(1): 79–92) analyse reports made by international organizations and government bodies, particularly, the US, dealing with various aspects of financial crime, import/export activity, and world trade statistics, in order to identify major challenges and possible solutions to the problem.
80. The paper finds that efforts to monitor and staunch the flow of illicit money through trade would be enhanced through more widespread coverage of customs cooperation and standardization of information sharing procedures between national customs agencies. Also, measures should be taken to make free trade areas (FTZs) more transparent to regulatory scrutiny.

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<sup>13</sup> Prem Sikka, ‘Enterprise, culture and accountancy firms; new masters of the universe’, *Accounting, Auditing and Accountability Journal*, vol 21, no 2, 2008, p 268-295,  
[www.emeraldinsight.com/Insight/viewContentItem.do;jsessionid=CD97B03F94E6B0C92BDA1B4D3D](http://www.emeraldinsight.com/Insight/viewContentItem.do;jsessionid=CD97B03F94E6B0C92BDA1B4D3D)

*Australian Institute of Criminology*

81. Sullivan and Smith (Paper: 2011 by Claire Sullivan and Evan Smith, Trade-Based Money laundering: Risks and Regulating Responses Published as Australian Institute of Criminology Reports -Research and Public Policy Series 115) contend that the formation of a regulatory framework to deal with TBML would be premature and unnecessary at this stage, as more research needs to be conducted to ascertain with greater precision the nature, risks and prevalence of TBML in Australia.
82. The Report identifies additional TBML methods besides those identified in the FATF Study 2006. The two other techniques involve:
  - (i) related party transactions; and
  - (ii) acquisition and sale of intangibles.
83. The Report further holds that the specific areas of risks increase the vulnerability of international trade to TBML. These risks are:
  - Barter trade
  - use of shell and front companies
  - trade with and through high risk jurisdictions; and
  - trade with and through free trade zones.
84. The Report recommends that future education and awareness-raising programs should usefully incorporate training materials on TBML.

## **CHAPTER II - STATISTICAL ANALYSIS**

85. An important objective of this Paper is to build on the existing studies, particularly those of the FATF. The past studies have raised issues in four key areas:
- (i) What is the extent of TBML in specific jurisdictions, regions and across the globe?
  - (ii) What should be the roles, responsibilities of investigating agencies and other allied agencies to tackle TBML;
  - (iii) What are the best practices (preventative measures) to effectively deal with TBML ; and,
  - (iv) What are those features of TBML which can make it possible to discern it from other forms of ML?
86. To look at these four primary areas of concern, this Chapter presents a Statistical Analysis. The statistical analysis is based upon the responses received from 19 Jurisdictions and 1 Organization, to a Questionnaire circulated by the APG Secretariat. Due to the limited number of responses received from jurisdictions & organizations the sample size is not large enough to lead to any statistically significant inferences. However, these responses do add to the understanding of the issues involved in each of the four primary areas of concern and can help crystallize work done in the future on TBML.
87. The Questionnaire, comprising six parts, was designed in such a way that each part could be answered by the Agency in the best position to furnish answers in any given jurisdiction. In all, 64 questions were circulated in the Questionnaire. The Six classes of agencies which have combined to answer the Questionnaire can be classified as follows:-
- (A) Coordinating Agency; (8 questions)
  - (B) Customs; (19 questions)
  - (C) ML Investigating Law Enforcement Agency (LEA); (17 questions)
  - (D) Financial Intelligence Unit; (7 questions)
  - (E) Tax Authority; (7 questions)
  - (F) Anti Money Laundering Regulator; (6 questions)

### **EXTENT AND PREVALENCE OF TBML PROBLEM**

88. The concern about the extent and prevalence of TBML across the globe has confronted investigators and policy-makers, as there are inherent difficulties in gauging the extent and magnitude of the problem. This Paper has highlighted a few of the difficulties which became obvious during the analysis of questionnaire responses. These difficulties may also go some way to explain why only a few cases of TBML have been reported.
89. In fact getting a sense of the magnitude of the problem has been the most challenging for this Paper. Walker J and Unger B in their Paper "*Measuring Global Money Laundering: The Walker Gravity Model*" (published in 2009 in Review of Law and Economics 5(2):821-853) have acknowledged that measuring global ML is still in its infancy. In most jurisdictions,

when data about ML is captured, there is no distinction made in the data with respect to cases of TBML.

90. Further, since in most jurisdictions the same investigating agencies investigate TBML cases and other ML cases, there is no distinction between the methods of detection, investigation and prosecution of the cases of TBML and of other forms of ML. Therefore, no separate statistics of TBML are available among most of the jurisdictions. Suspicious Transaction Report (STR) database of FIUs also generally do not distinguish between TBML STR and other STRs.
91. A general lack of awareness about the red flags of TBML and the multiplicity of authorities which deal with elements of international trade transaction increases the challenges with the detection and investigation of TBML cases. Resultantly fewer cases are being reported, thereby making estimation of the correct size of TBML almost impossible.
92. Responses which have been received from 20 jurisdictions/organizations indicate the following:
  - a) 45% of the respondents have attributed the reason for so few cases of TBML being reported is the lack of training / awareness and limited resources being allocated for the purpose. Most of the jurisdictions have responded that they have not undertaken sufficient studies and/or risk assessments on TBML; abuse of trade finance; transfer pricing, and alternative remittance systems.
  - b) 40% of the respondents have attributed the reason for low reporting of TBML cases as their law and current policy. It is interesting to note that such law and policy relate to trade policy and to Customs law. For instance, in a few jurisdictions, violations of Customs law have not been included as a predicate offence under their national AML Law. Consequently, a lower number of cases of TBML have been detected, reported or investigated. A few jurisdictions stated in the questionnaire that low rates of Customs duties / taxes effectively lower the incentive of 'over and-under invoicing' of shipped goods. Since the aim of criminals using TBML is to earn ineligible export incentives and evade customs duty there have been few TBML cases recognized. Others have responded that Customs officers are primarily required to detect and investigate cases of undervaluation / overvaluation of export / import of goods / services, and are not primarily responsible for enforcing the national AML/CFT laws therefore, a limited number of TBML cases are detected. Among other policy/law issues highlighted in the questionnaire were, the absence of proper categorization of TBML cases and hence the nonexistence of separate data for TBML cases. This was explained by the observation that the priority of the authorities, till recent times, has been to prevent ML by the other two significant methods of ML, namely, cash remittance and bulk cash smuggling, rather than through TBML.
  - c) Only 20% of respondents indicated that TBML was not an issue despite the low recording rates. Reports received from respondents reveal that for a few jurisdictions, international trade is an insignificant percentage of their GDP, hence possibility for TBML is also limited.

93. It appears from the analysis that the low level of cases that have been reported on TBML are largely due to a lack of awareness and training about TBML among the jurisdictions. It follows then that any available statistics will be an underestimate of the true extent of the TBML problem.
94. To ascertain the extent of TBML an attempt has been made in this Paper to see whether all known forms of TBML have been covered by the past studies or whether there is scope for further expansion.
95. Analysis indicates that 55% of the respondents have stated that the FATF studies of the past have covered all known types of TBML. Whilst this leaves scope to explore other types of TBML a few jurisdictions have also reported that the following aspects of TBML call for sharper focus than what has been achieved in the past:
- i. 'Under /over pricing' of **services** need to be targeted separately due to its peculiar nature
  - ii. **Terrorist financing** and its linkage to TBML
  - iii. Misuse of **Trade Finance**.
96. The most challenging aspect relating to the extent of TBML given the current sample size, has been to arrive at any conclusion about the magnitude of the TBML problem. Perhaps one way of such estimation may be by looking at the number of TBML investigations which have been carried-out; the average size of TBML offence; and, the number of STRs generated in this regard, over the last five years. Even this methodology is flawed by the fact that most of the jurisdictions do not maintain separate statistics for TBML as a distinct from other ML offences and therefore no meaningful inferences can be drawn. However, for the sake of completeness and record, this report will present the few statistics provided, though the results are unlikely to be representative of regional or global patterns.
97. Five jurisdictions reported on the numbers of TBML investigations in the TBML questionnaires. Between 2007 and 2011 investigating authorities in the jurisdictions reported 289 investigations. The number of identifiable TBML STRs generated between 2007 & 2011 has been 1994. The average size of a TBML offence is USD 1.93 million (USD 557.32 million involved in 289 cases), based upon the responses received. The total value of assets forfeited by two of these jurisdictions between 2007 and 2011 on account of TBML was USD 144.35 million.

## CONCLUSION ON THE EXTENT AND PREVALENCE OF TBML

98. This study has not been able to draw definitive conclusions on the extent and prevalence of TBML. The few cases reported by the limited number of jurisdictions undermine estimation of the size of TBML. To what extent TBML is in use remains a concern as a straight answer is not available due to the lack of awareness and paucity of training on TBML among the jurisdictions. All the aspects of TBML are not even covered by those jurisdictions which have reported TBML statistics. There is no standardization with regard to the practice of collection and maintenance of data on TBML. Even then, it is obvious that TBML is a



problem for many of the jurisdictions and has tremendous potential as an avenue to launder money.

99. Despite the findings in this Paper in relation to lack of awareness; in tandem with the limited number of TBML studies that have been done by jurisdictions; and, the lack of separate statistics for TBML, it is still asserted by the project team, with some measure of confidence, that these statistics, although underestimating the problem, do go some way to corroborate the significance of TBML as an increasingly important avenue for laundering of proceeds of crime.

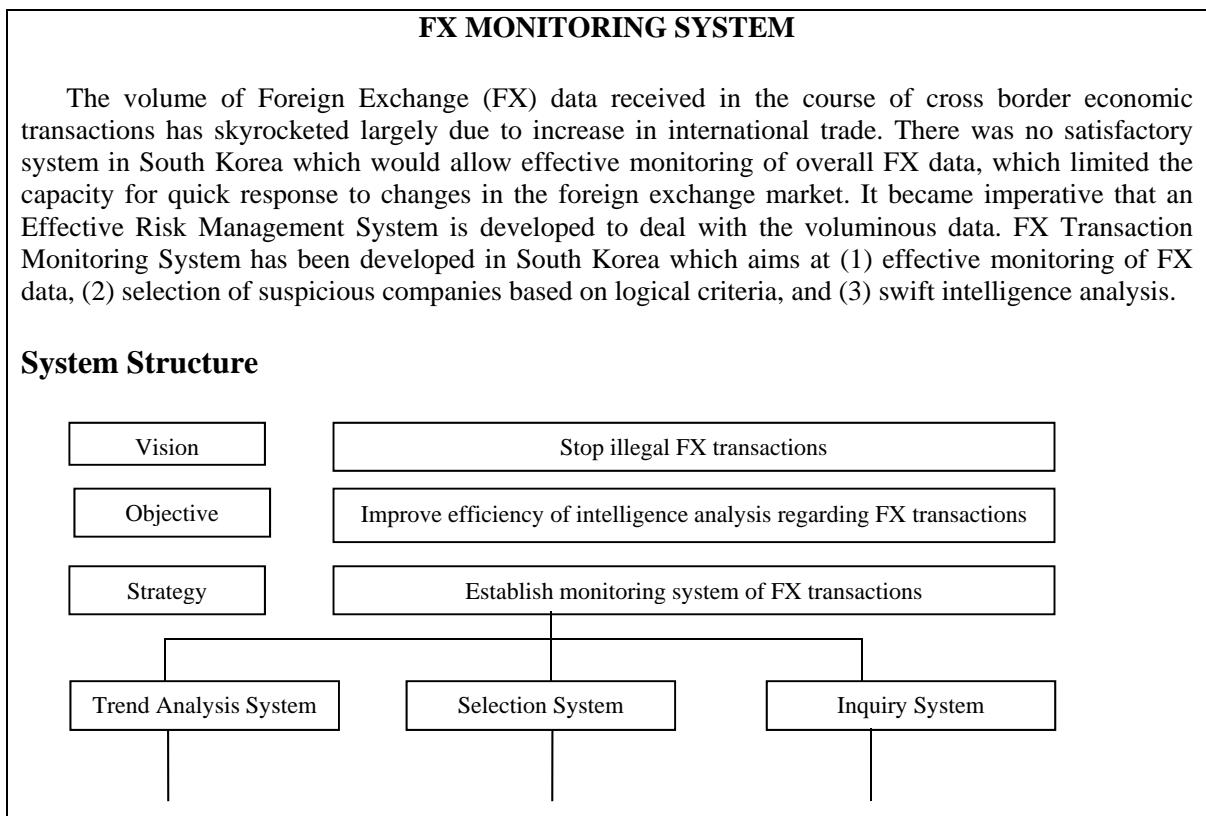
## **ROLE OF AGENCIES RESPONSIBLE FOR TACKLING TBML**

100. The 2006 FATF Paper on TBML pointed out that trade data analysis is a useful tool to discover trade anomalies,, which in turn can lead to detection, investigation and prosecution of cases of TBML. The questionnaire sought to consider which agencies are responsible for collecting and managing trade data; what risk management analysis is undertaken for such data; and, whether it is the same agency or some other agency which undertake TBML investigation. The study has sought to determine the role of other allied agencies including the regulators in this regard.
101. Almost all the jurisdictions reported that at least one department within Government records and manages information on goods imported and exported into the jurisdiction. In most of the jurisdictions, it is the Customs Department that does this. In a few jurisdictions, other agencies like the Economic Services Bureau, Free Zone Authorities, Census and Statistics Department, Port Terminal Operators also record and manage information on goods imported / exported. In most of the jurisdictions, information databases are maintained by Customs and these databases record all relevant information both on imported and exported goods. In response to questions on whether information is collected on: the type of goods; value of goods; importer details; exporter details; owner details; receiver details; and, shipping company details etc, almost all the jurisdictions have reported that all this information is collected. Generally, a Customs Declaration Form is used to obtain this information, which besides being used for tax / duty purposes, can also be used for the purpose of detecting or investigating TBML cases. The Questionnaire circulated among jurisdictions also sought to ascertain whether the jurisdictions collected information to identify the true value of goods, i.e. whether there is under/overpricing. 60 %of the jurisdictions have advised that they are using data within the various databases to help identify the true value of goods, i.e whether goods have been under/overpriced, by attempting to ‘normalise, Trade Pricing.
102. 75% of the jurisdictions have indicated that the relevant Customs agencies are also maintaining an intelligence database on import and export of goods; however, 30% reported that Customs also cross reference this information with other government databases, i.e. companies registry, tax records, criminal records etc. Only 20% of the respondents indicated that Customs conduct ML investigations. In most of the jurisdictions, ML investigations were done by a separate ML investigating agency. In these jurisdictions Customs generally referred the potential TBML cases to an investigating agency mandated to investigate ML cases.

103. Only 25% of respondents have reported that Customs have dedicated financial investigators with experience in trade related offences and/or ML investigations. Thus in most of the jurisdictions, although Customs capture and manage the information on goods imported and exported into the jurisdiction, they have either no authority to investigate ML cases or even where they have such authority, they don't have dedicated financial investigators with experience in trade related offences and/or ML investigations.
104. About 50% of the respondents have indicated that Customs personnel are part of joint financial investigation/ML task forces in those jurisdictions. In a few jurisdictions, Customs officers are members of Anti-Money Laundering Working Groups. The working groups do not conduct investigations; however their members do share information, typologies, and emerging trends on ML.
105. 45% of the respondents have reported that the law enforcement agency mandated to investigate ML cases is part of a joint financial investigation/ML task force that conducts investigations into TBML offences. The same percentage of respondents have reported that ML investigating agency have specialist financial investigators to conduct the TBML investigations.
106. Only 15% of the jurisdictions have reported that their FIU form part of any joint financial investigation/ML task forces that conduct investigations into these offences. In the majority of jurisdictions, the relevant FIU is not part of any joint financial investigation/ML task forces that conduct investigations into TBML offences and is designated as the agency responsible for carrying out day to day functions of the ML Reporting Authority only i.e. functioning as an administrative FIU.
107. Only 15% of the jurisdictions have reported that their relevant Tax Authority conduct investigations/audits into TBML. Most responses indicated that the main aim of tax authorities in their jurisdiction was to ensure tax compliance and not to focus on detecting suspected criminal activity of ML. In most of these jurisdictions, there was no detection of any link between TBML and transfer pricing and no case of TBML was detected out of tax compliance audits.
108. Only 25% of the jurisdictions reported that members of the relevant Tax Authority were part of any joint financial investigations/ML Task Force that investigates TBML.
109. More than 50% of the jurisdictions have indicated that the relevant regulator or supervisor are providing guidance to reporting entities regarding TBML vulnerabilities and red flags. Such guidance includes dissemination of examples of suspicious transactions (red flags in relation to trade finance, typologies report and papers issued by either FATF or APG) so as to enhance awareness. Some responses indicate that although no specific guidance was provided in relation to TBML, more general guidelines about AML/CFT were issued to the banking and financial institutions. One jurisdiction indicated that they had established specific examination procedures relating to a range of banking activities, products, and services, including trade finance activities, in the form of an AML Examination Manual. Feedback also indicated that supervisors regularly participated in industry forums, regulator

panels, and other outreach activities so as to provide financial institutions with guidance relating to TBML risks.

- 110. 50% of the jurisdictions indicated that their AML supervision regime include trade finance aspects of compliance. Response received from one jurisdiction also indicated that in its jurisdiction, AML supervision applied a risk-based approach to scoping and planning its AML supervisory functions.
- 111. Only 40% of jurisdictions indicated that the regulator or supervisor was providing training to reporting entities and to its own staff. Further, only 25% of jurisdictions have reported that regulators have experts in the area of Trade Finance. However, jurisdictions were unanimous that there is a need for training to be provided to regulators about AML risks and vulnerabilities associated with trade finance activities as they, the regulators, would benefit from better training and awareness.
- 112. 55% of the jurisdictions indicated that their jurisdictions had in place foreign currency controls. However, 25% of jurisdictions reported that in their opinion, such “foreign currency control” had a role in identifying abuse of trade finance or TBML. Thus, it may be extrapolated that in these 25% of jurisdictions the aim and objective of foreign currency controls, are not specifically to target abuse of trade finance or TBML. However, the significance of foreign exchange manipulation in adding to the vulnerability from TBML in international trade and the necessity to monitor foreign exchange data to reduce such vulnerabilities are demonstrated by the contribution from South Korea in the box item placed below.



(1) Time series information on trend of changes in FX data

(2) Information on abnormal FX transactions.

(1) Selection model utilizing statistical method.

(2) User-oriented selection model.

(1) Detailed analysis on FX Balance Sheet (B/S).

(2) One-click inquiry about detailed transaction records.

The Trend Analysis System monitors all FX data (including inward /outward remittances and purchase of bill of exchange) collected by Korean Customs for working out trends of changes. The System categorizes FX data by industry or jurisdiction month-wise so as to provide inquiry service about time series information. Users can take a look at trend of changes in industry-/jurisdiction-specific FX data. The System brings out changes considered abnormal with regard to overall FX data; or FX data by major industry or jurisdiction. Transactions are regarded as abnormal which show abrupt changes compared to average value of the recent three years. Once abnormal transaction is spotted, the system provides relevant information to experts in charge of intelligence analysis. The experts would compare such abnormal inflow or outflow of FX for that industry or jurisdiction with data of exports or imports made from/to that industry/jurisdiction.

The Selection System calculates scores of all exports/imports by taking advantage of statistical method (data mining). Based on the scores, the System helps users to select suspicious companies. Crimes related to FX transactions are categorized into four categories based on applicable legislations and violation types viz. (1) Violations in terms of payment method, (2) Violations in terms of the report of capital transaction, (3) illegally moving property abroad, and (4) ML (which include trade abuse through mispricing etc.) For example ML may occur through inward remittances to multiple bank accounts disguising wire transfers as being related to trade activities. On analysing past crimes of four types of violations, risk profiles of companies are drawn. The System also provides a user-oriented selection model whereby experts in charge of intelligence analysis choose risk factors; and adjust value or ratio depending on their analysis purpose to select suspicious companies. One-click inquiries about suspicious companies regarding their records of export/import clearance and foreign exchange transactions are made possible.

The Inquiry System provides refined FX Balance Sheet (B/S), which reflects position of individual companies and jurisdiction-specific FX B/S of trading partners. Foreign exchange B/S is basic data for intelligence analysis on FX transactions. The B/S allows comparison between export/import amount and receipt/payment of FX money during certain period. The System builds jurisdiction-specific B/S by linking export/import data and FX data of each trading partner jurisdiction; and provides visualized results such as tables and graphs. The System enables one-click inquiry about general information of export /import and FX data of individual companies. The System is equipped with user interface which not only allows selection of suspicious companies but also enables search for raw data of transaction records of each company. Such a System can shorten inquiry time.

113. Only 15% of the jurisdictions have reported that during investigations of Alternative Remitters, they have identified instances of TBML. Further only 10% of the respondents reported that during such investigations of Alternative Remitters, they have identified instances of abuse of trade finance. 40% of the respondents did not submit any response in respect to questions concerning alternative remittance systems.

## **CONCLUSIONS ON ROLES OF AGENCIES**

114. The statistical analysis reveals that ‘trade data’ is collected and managed by at least one of the Government Department in each jurisdiction. In most of the jurisdictions that Department is the Customs Department which not only collects and manages ‘trade data’ but also uses the data to detect and investigate violations of Customs Law relating to evasion of Customs duty. However, in most of the jurisdictions, the Customs Department does not have the authority to conduct any ML investigation including TBML investigation. It appears that the agency responsible for ML investigations in those jurisdictions conduct all ML investigations including TBML investigations.
115. The Tax authorities in a large number of jurisdictions also have a limited role to play in investigation of TBML cases. While regulators in most jurisdictions do sensitize their reporting units about the abuse of finance products emphasis on the significance and relevance of these products in detecting TBML does not appear to be high. The lack of trade finance investigators and absence of ‘systems’ capable of cross-referencing trade data with that of trade finance are important limitations.

## **DOMESTIC & INTERNATIONAL COOPERATION AND TRAINING**

116. Professional specialization of any agency makes it more proficient to carry-out its mandated work. However, a complex problem like TBML which cuts across more than one sector of an economy and goes beyond the national borders require considerable cooperation among agencies both domestically and internationally in order to provide solutions. To address this, a set of questions were incorporated in the Questionnaire so as to determine the extent and manner of cooperation among agencies both at the domestic and international levels. The FATF Paper on Best Practices published in 2008, has recommended having joint task forces among domestic agencies to ensure domestic inter-agency cooperation.
117. This Paper suggests strengthening the arrangements concerning exchange of information by fortifying mutual legal assistance agreements to support more meaningful international cooperation. One significant method of building such best practices has been the suggestion to include TBML orientation in ML training programs. Another set of questions in the Questionnaire relate to the exposure to TBML training for the agencies concerned.
118. The project team has categorized that there are three broad phases of domestic cooperation among the competent authorities namely: sharing of intelligence; coordination in investigation; and, support in prosecution.
119. The statistical analysis reveals that only 55% of the jurisdictions have submitted a response to the question of how the TBML investigations were initiated. 30% of the jurisdictions reported that the inputs for TBML investigations came from intelligence and STRs. 45% of jurisdictions reported that inputs for TBML investigation came from law enforcement agencies whereas only 25% of jurisdictions reported that the source for initiating TBML investigations was “Trade Data”. For almost 35% of the respondents, suspicious transactions related to TBML were first reported to FIU, which conducted analysis before reporting it to the relevant investigating authority.

120. 35% of jurisdictions reported that TBML investigations by ML investigating agency are initiated from 'internal intelligence' whereas 55% of respondents reported the source of intelligence for ML investigating agency as 'referrals from other agencies'. Jurisdictions reporting 'internal intelligence' as the source for initiation have also reported that 'referrals from other agencies' are another source for initiating TBML investigations. A few jurisdictions have also reported referrals from the 'private sector'. 60% of responses received indicate that they receive information from the relevant Customs agency. However, 35% of the jurisdictions stated that though their ML investigating agency receives information from Customs there are restrictions on the use of that information.
121. In response to the question on the types of impediments faced in use of information received from other agencies, 25% of the jurisdictions have reported that there are impediments which have been identified as: resource constraints; lack of training; delay in release of further information; and, the inability to justify an inquiry. It is interesting to note that limited capacity to match trade data with financial transaction information also hinders the capability of the FIU to proactively assess possible TBML-related transactions.
122. 30% of the jurisdictions have reported that there are impediments encountered in the extending of cooperation while conducting investigations. According to the survey the main impediments encountered during the course of investigations were maintaining confidentiality; inhibited from using such information in prosecution / legal proceedings; non-disclosure to third parties without consent; and, use of juridical information only with the authorization of a magistrate (or judicial authority).
123. 90% of the jurisdictions submitting response to the Questionnaire reported that Customs agencies receive financial information from the FIU. According to the responses the FIU generally provided such information spontaneously or upon request. However, responses received also revealed that in some countries, there is requirement to sign a Memorandum of Understanding before sharing of information can take place. In one jurisdiction, the FIU has a Memorandum of Understanding (MOU) with several partner agencies/departments. These Partner Agencies according to the response have on-line access which allows them to ask for financial information relevant to all investigations. According to the response, the MOU framework accounts for objectives of each agency and is aligned with national interests.
124. 30% of the respondents have indicated that the Tax Authority receives FIU data for the purpose of investigation of administrative issues. However, to what extent such data relate to TBML has not been indicated.
125. Since TBML occurs across national borders, the best practices for strengthening international cooperation recommended by the FATF in 2008 and supported by the project team needs to be emphasized. Mutual Legal Frameworks with effective gateways must be capable of facilitating prompt exchange of information and trade data.
126. 55% of the jurisdictions have indicated that they seek information from their international counterparts during ML investigations. Responses received indicate that jurisdictions

provide and share intelligence with the Regional Intelligence Liaison Office and World Customs Organization. Some share 'trade data' with their partner countries in terms of specific information sharing agreements to exchange trade data. 40% of the respondents have indicated that they seek information from FIUs and LEAs in other countries. 40% of the respondents have advised however that there are impediments to the receipt or dissemination of this information. The most common impediments identified in the survey are: "supply and use of information under the secrecy clauses"; signing of relevant MoUs; lack of a clear document of mutual administrative assistance in areas that are not under the control of Customs; delay in response; and, use of financial information obtained from the FIUs being limited to intelligence purposes only etc. Further, it was identified that restrictions occur without the existence of a multilateral trade agreement for the use and sharing of information with other foreign partners.

127. About 30% of the jurisdictions indicated that they have shared TBML related intelligence with foreign counterparts. However, 15% jurisdictions have reported that they were not made aware of the results of that dissemination.
128. 70% of the respondents advised that international requests have been made for sharing financial intelligence. Responses also indicate that in some jurisdictions, trade-related information can be shared with other FIUs within the framework of MOUs. Operationalising international cooperation by developing a common platform to share and analyse trade data of trading partners so as to combat TBML is demonstrated by forming Trade Transparency Units (TTU). The challenges met by formation of a TTU and its basic features have been explained in the contribution made by the USA in the box placed below:

#### **TRADE TRANSPARENCY UNITS (TTU)**

TBML schemes are often accomplished through customs fraud violations such as over & undervaluation, over & under-shipment, false invoicing, double invoicing, and the Black Market Peso Exchange. Due to the complex nature of international trade systems, law enforcement agencies are only able to see one side of the trade transactions. Criminal investigators might have expertise and experience investigating either financial or customs fraud crimes, but do not have the full financial and trade data that would give them a complete picture of the scheme. This lack of transparency often catalyzes the use of TBML by Transnational Criminal Organisations (TCOs).

Furthermore, as international trade has expanded, so also has the range of activities that TCOs are involved in. This has led to TCOs evolving into loose networks who work together in order to exploit new market opportunities. Such rapid evolution calls for international law enforcement agencies to take a more integrated approach to address this threat. However, many challenges on integration, such as communication and cooperation, still present themselves. Law enforcement agencies are often hamstrung when it comes to sharing information with international partners, relying on traditional diplomatic channels such as Mutual Legal Assistance Treaties (MLATS) or Customs Mutual Assistance Agreements (CMAAs), in order to gather or exchange information on criminal or terrorist threats. These agreements are often lacking in scope and can take considerable time to execute the exchange of information. Additionally, International trade transactions inherently occur behind multiple sides of international borders involving multiple parties and many layers of documentation and paperwork. This complexity and lack of transparency make these transactions highly susceptible to fraud and exploitation.

Another core issue is the disparity of the capacity and capabilities between different international law enforcement agencies. A uniform understanding of the threat and threat space is a key starting point

amongst partnered countries, followed up by in-depth co-sponsored training that will eventually close the knowledge gap on TBML. Law enforcement agencies must follow a uniform methodology in attacking TBML if they are to be successful. Agencies must have adequate strategic, operational, and tactical intelligence capabilities. Also, agencies must have a platform to share trade data across borders with partner countries. Finally, countries must have adequate prosecutorial authorities and arrest powers for their agencies to attack the threat.

In 2004, United States Homeland Security Investigations (HSI) initiated the Trade Transparency Unit (TTU) to prevent, combat, and dismantle TCOs that engage in TBML. TTU develops partnerships with customs and financial agencies around the world to detect trade discrepancies and to investigate criminal violations including TBML. TTU focuses on the sharing of trade information with international partners allowing each TTU to compare values reported on U.S. import/export declarations against the corresponding values reported on foreign counterpart import/export declarations. Investigators are thus able to see both sides of the trade transaction, thereby adding a level of transparency.

The process starts when HSI reaches out to jurisdiction representatives, to further discuss a potential partnership under the TTU umbrella. Thereafter trade data of the partner jurisdiction is formatted. Agreements are signed and guidelines are established for the sharing of trade information. The access to the shared TTU trade software system is the key component that allows the TTUs to operate. TTU has developed a proprietary computer-based system called "Data Analysis & Research for Trade Transparency System" (DARTTS) to host and analyse the combined international trade data, which allows the user to identify abnormal trade transactions that may indicate TBML, customs duty evasion, and other related customs and financial crimes.

Direct communication amongst international partners is highly encouraged. Personnel assigned to the TTUs meet regularly to exchange ideas, discuss emerging trends and to provide each other support, guidance, training, and tools to combat TBML.

129. The FATF Best Practices Paper 2008 urged for a stronger focus on training programmes for competent authorities to enhance their ability to identify TBML techniques which is also supported by the project team. Such programmes, particularly those directed towards investigating and other allied agencies, must highlight the relevance of both financial and trade data to assist programme participants in detection of TBML cases.
130. 40% of the jurisdictions indicated that Customs have received training on TBML. Further, only 10% indicated that they provided training to others. Most of the jurisdictions have agreed on the need for better training and understanding of the techniques of TBML. Even on the question of 'challenges and obstacles for the Customs agency', a common response was that besides the 'lack of authority for Customs to investigate TBML cases' (legal issue), 'lack of training and resource' was indicated as a major challenge for Customs to identify or investigate TBML.
131. 35% of the jurisdictions indicated that relevant ML enforcement agencies had received training on TBML. Further, only 15% of the jurisdictions reported that they provide training to other agencies on TBML issues. The main methods of training have been stated as, 'attending local and overseas training and seminars'. Most of the jurisdictions agreed on the need for better training and awareness of the techniques of TBML.



132. Only 35% of the jurisdictions have indicated that the FIU has received training on TBML. Equal numbers of jurisdictions have indicated that FIU is also providing training to other agencies on TBML issues. The mode / method of training are through the participation in international conferences, seminars and overseas training. Material relied upon in the training include annual reports of FIUs, typologies, sanitised cases and indicators linked to TBML latest studies & papers etc. 20% of the jurisdictions have informed that their Tax Authority received training on TBML. Further only 5% have indicated that their Tax Authority provides training to others on TBML issues. Responses received from jurisdictions indicate that officers of Tax Authority are trained to conduct tax audits and no training with specific reference to audit in TBML cases has been received by the said officers.
133. Training to those responsible for detection and investigation of TBML as well as to those who collect trade data and handle trade finance is critical to raise their awareness about TBML and build capacity to identify TBML. Since in majority of jurisdictions those who handle trade data, who deal with trade finance and who investigate TBML belong to separate agencies the significance of building mechanisms for domestic cooperation cannot but be emphasized. Sharing of trade data across trading countries supported by prompt exchange of information during investigation and for prosecution can be very important for preventing and curbing TBML. However, there are impediments in exchange of information both domestically and internationally.

#### **PATTERNS OF FINANCIAL PRODUCTS USED**

134. On the issue of financial or banking products used for TBML, responses received from the jurisdictions indicated that formal banking channels as well as alternative remittance system are being used. Normal banking channels that have been used to finance trade are open accounting system and letter of credit mechanisms. The gaps between declared trade transaction value and the true value of goods have often been filled-up through alternative remittance.

#### **RED FLAGS AND PATTERNS**

135. The last set of questions in the Questionnaire relate to eliciting responses from the jurisdictions about the indicators which can help discern the patterns of TBML. The FATF Best Practice Paper 2006 has regarded making case studies and red flags available to competent authorities and financial institutions as a basic principle of guidance to foster the capacity to combat TBML. The patterns and red flags help in identifying the occurrence of ML in trade and trade finance transactions. The jurisdictions which responded to the Questionnaire have listed a large number of patterns and red flags which this Paper has categorised in five broad groups: i) Trade Finance; ii) Jurisdictions; iii) Goods; iv) Corporate Structures; and v) Predicate Offences. The last four categories have been dealt with in the past papers under the broad category of trade.
136. TBML can take many forms and the distinction between it and other forms of ML which use the financial system is often blurred. Efforts have been made in the present section of this Chapter to identify and describe specific characteristics of TBML and hence this

Section has examined and analysed trade characteristics as patterns of jurisdictions, goods, corporate structures and predicate offences. Red flags identify only possible signs of illicit activity and have to be considered in conjunction with the normal transaction activity expected.

137. Based on the responses received from jurisdictions, red flags relating to financial & banking products may be categorized as follows:

- a) Use of **letters of credit** to move money between those countries, where such trade would not normally occur and / or is **not consistent with the customer's usual business activity**. A Letter of credit is generally resorted to so as to accord more legitimacy to the transaction in order to conceal the real facts.
- b) The **method of payment** requested by the client appears **inconsistent with the risk characteristics of the transaction**. For example receipt of an advance payment, for a shipment, from a new seller in a high-risk jurisdiction.
- c) The transaction involves the receipt of cash (or by other payment methods) **from third party entities** that have no apparent connection with the transaction or which involve front or shell companies or wire instructions / payment from parties which were not identified in the original letter of credit or other documentation. The transactions that involve payments for goods through cheques, bank drafts, or money orders not drawn on the account of the entity that purchased the items also need further verification.
- d) The transaction involves the use of repeatedly **amended or frequently extended letters of credit** without reasonable justification or that includes changes in regard to the beneficiary or location of payment without any apparent reason.
- e) **Unusual deposits** i.e. use of cash or negotiable instruments (such as traveller's cheques, cashier's cheques and money orders) in **round denominations** (to keep below reporting threshold limit) to fund bank accounts and to pay for goods and services. The negotiable instruments may be sequentially numbered or purchased at multiple locations and may frequently lack payee information. Further, cash payments for high-value orders are also indication of TBML activity.
- f) Inward remittances in **multiple accounts** and payments made from multiple accounts for trade transaction of same business entity are indicators for TBML. In this regard the study of foreign exchange remittances may help detect the offence.
- g) In the case of **merchanted trade**, the trade finance mechanism should be in place for both export leg as well as import leg of transaction. If the Trade Finance mechanism, for example, Letters of Credit, have been provided for only the import leg of the transaction and not for export leg, it also indicates the possibility of TBML.

## **PATTERNS OF JURISDICTION (FROM WHERE OR TO WHOM, GOODS ARE USUALLY SHIPPED/TRANSHIPPED)**

138. The Questionnaire also intended to ascertain patterns from jurisdictions as to or from where goods usually shipped. Responses received indicated that in 90% of jurisdictions, no such patterns had been identified to date, either because of the low numbers of TBML cases or due to other reasons such as a study of this type had not been carried out. Responses indicated that existence of duty free zones or jurisdictions having high import tax / export tax rebate are most likely to be used for TBML. Volume of trade, value of trade, type of commodity or service traded and/or the domestic regulatory environment are the factors which determine the sensitiveness of a jurisdiction for TBML. Generally, all the factors combine to make a jurisdiction prone to high risk of TBML.

## **RED FLAGS WITH REGARD TO JURISDICTIONS**

- a) The commodity is shipped to or from a jurisdiction designated as '**high risk**' for ML activities or sensitive / non co-operative jurisdictions.
- b) The commodity is **transhipped** through one or more such high risk / sensitive jurisdictions for no apparent economic reason.
- c) Presence of **Free Trade Zones / Special Economic Zones** also affects the sensitiveness of a jurisdiction as far as TBML is concerned. FTZs are also emerging as being especially vulnerable to TBML. FATF (2010: 4) defines FTZs as 'designated areas within countries that offer a free trade environment with a minimum level of regulation'. In the said report, FATF noted that most zone authorities operate separate company formation services from those that exist in the rest of the jurisdiction and market the ease of setting up a legal entity in an FTZ to attract business. Many zone authorities request little or no ownership information of the companies interested in setting up in the zone. As a result, it is simpler for legal entities to set up the firms/companies in FTZs and hide the name(s) of the true beneficial owners. This lack of transparency has allowed companies located in FTZs to create layers of transactions that are difficult (if not impossible) for law enforcement agencies to follow (FATF 2010). It also reported that 'goods introduced in a FTZ' are generally not subject to the usual customs controls, with goods undergoing 'various economic operations, such as transshipment, assembly, manufacturing, processing, warehousing'. FinCEN has identified TBML red flags that are specific to FTZs. In its 2010 report, FinCEN (2010: 4) signalled that a number of red flags seen in conjunction with shipments of high dollar merchandise (such as electronics, auto parts and precious metals and gems) to duty free trade zones could be an indication of a trade-based money laundering activity.

These include:

- i. third-party payments for goods or services made by an intermediary (either an individual or an entity) apparently unrelated to the seller or purchaser of goods. This may be done to obscure the true origin of the funds;
- ii. amended letters of credit without reasonable justification;

- iii. a customer's inability to produce appropriate documentation (ie invoices) to support a requested transaction; and
  - iv. significant discrepancies between the descriptions of the goods on the transport document (ie bill of lading), the invoice, or other documents (ie certificate of origin, packing list etc) (FinCEN 2010).
- d) **Circuitous route of shipment** and/or **circuitous route of financial transaction** or **Order for the goods** is placed by firms or individuals from foreign countries other than the jurisdiction of the stated end-user.
- e) Transaction involves **shipment of goods inconsistent with normal geographic trade patterns** of the jurisdiction i.e. trade in goods other than goods which are normally exported/ imported by a jurisdiction or which does not make any economic sense e.g. Semi-conductor manufacturing equipment being shipped to a jurisdiction that has no electronics industry.

## **PATTERNS OF GOODS INVOLVED IN TBML**

139. Most of the jurisdictions have responded to state that no definite pattern of goods involved in TBML is identifiable. This is probably due to the vulnerability of almost all trade transactions for TBML, irrespective of the goods involved. A few studies including that of Clare Sullivan and Evan Smith cited earlier, have emphasized the vulnerability of trade in services for TBML. Global trade in services provide greater opportunities for ML than trade in merchandise because fraud particularly in regard to valuation of services is more difficult to detect and prove. The intangible nature of services makes even facts of supply / delivery / provisioning difficult to determine. Unlike merchandise, services are also less likely to be standard, so anomalies in value and price are less apparent and more difficult to substantiate. However responses do indicate that goods involved in TBML will be usually those goods, where it is rather difficult to identify true value, due to the nature of these goods. Further responses also indicate that vulnerable goods are those which are subjected to higher taxes/ duties or are high turnover goods or are high valued goods. Examples of such goods are consumer goods, textiles, garments, engineering goods, electronics goods, illicit tobacco products, leather goods, luxury cars, precious metals, counterfeit products, diamonds, metal scraps. Illicit trade in tobacco has been identified as prone to ML as such trade is cash intensive, profitable with low levels of risk, and the possibility of intermingling of illicitly generated funds with legitimate forms of business is high.

## **RED FLAGS WITH REGARD TO GOODS**

- a) Where significant discrepancies appear between the **description, quality and quantity** of the goods on the documents such as bills of lading, invoices etc and the actual goods shipped. The misrepresentation may also be in relation to or type / grade of goods. For example, a relatively inexpensive good is supplied but it is invoiced as being more expensive, of different quality or even as an entirely different item so the documentation does not accurately record what is actually supplied. This technique is particularly useful in TBML. Cheap cloth items / waste thereof are declared as premium quality garments to launder the criminal money.

- b) Significant discrepancies appear between the **value** of the commodity reported on the invoice and the commodity's fair market value. This is done either in conjunction with mis-declaration of the description / quality / grade of goods or without it. This is also often associated with mis-declaration of the jurisdiction of origin.
- c) **Consignment size or type of commodity** being shipped appears **inconsistent with the scale or capacity of the exporter or importer having regard to their regular business activities** or the shipment does not make economic sense i.e. there is no reasonable explanation for the client's financial investment into the shipment.

## **PATTERN OF CORPORATE STRUCTURES**

140. To adduce information about the types of corporate structures i.e. Companies, Partnership Firms, Proprietorship, Offshore Companies etc. used by criminal syndicates in TBML, relevant questions were included in the Questionnaire. Responses indicate that both domestic companies as well as overseas companies are used by criminal syndicates. Bogus registered companies (behave like true consignor / consignees of goods) and offshore companies located in tax havens have been reported as corporate structure misused by criminal syndicates. The use of offshore companies is also associated with complex schemes and methodologies utilized by established criminal enterprises.

## **RED FLAGS WITH REGARD TO CORPORATE STRUCTURES**

- a) The transaction involves the use of **front or shell companies**. Both shell and front companies can be used to facilitate TBML but in different ways. A shell company has no real operating activity and is used to hide ML activity and the identities of individuals involved so as to obscure the money trail. If activity is traced to the company it is literally an empty shell. As FATF (2010: 20) explained TBML and other ML schemes rely on the ability of the perpetrator of the crime to distance themselves from the illicit proceeds. Shell companies enable illicit actors to create a network of legal entities around the world. By contrast, a front company has real business whose legitimate operations are used as a cover for ML and other criminal activity. In many ways, front companies present a much more significant TBML threat than shell companies. The characteristics of offshore companies, for example, convenient formation, free operation, tax exemption and financial secrecy, all provide rather good veneer to disguise ML
- b) Numerous **sole proprietorship businesses/private limited companies** set up by seemingly unrelated people (proxies) are found to be controlled by the same group of people. For the setting up of such businesses false addresses are registered.
- c) Trade transaction reveals links between representatives of companies exchanging goods i.e. same owners or management. TBML requires collusion between traders at both ends of the import/export chain. **Related party transactions** (ie transactions between entities that are part of the same corporate or business group) can possibly make TBML easier and more difficult to detect. Related party transactions, including transfer pricing, rely on mutual agreements between the parties, rather than free market forces. As the FATF (2006: 5) pointed out, over-

or under-invoicing of goods and services requires collusion between the exporter and importer. Although there is a higher risk of related party transactions being used for fraud and for TBML, dealings between related parties are not necessarily illegal.

- d) **Transfer pricing** is a related party transaction that is commonly used by transnational corporation as part of their financial and tax planning strategy. Multinational organisations use transfer pricing to shift taxable income from jurisdictions with relatively high tax rates to jurisdictions with relatively low tax rates to minimise income tax. Similar strategies are also employed in relation to import duties and value added tax. FATF (2006: 3) made it clear though that in the case of transfer pricing, the reference to over- and under-invoicing relates to the legitimate allocation of income between related parties, rather than customs fraud. However possibility of TBML originating in transfer pricing cannot be ruled-out.

### **PREDICATE OFFENCES OF TBML**

141. 15% of the jurisdictions have reported that **tax evasion** is the predominant predicate offence in TBML cases whereas 10% of the jurisdictions have reported **customs offences** as the main predicate offence. Other responses indicate that predicate offences are often related to commercial fraud, IPR, Narcotics, human trafficking, terrorist financing, embezzlement, corruption, organized crime (racketeering), dealing in banned goods, conducting illegal business, speculation etc. One Reporting jurisdiction indicated that ML is considered to be an autonomous offence and there is no need to prove the existence or nature of the predicate offence in order to prosecute hence as a consequence, there is no systemic link between ML cases and other crimes.

### **CONCLUSION ON RED FLAGS**

142. The attempt here to segregate Red Flags for different segments of TBML is to simplify the process of understanding the complex problem of TBML. In real life situations the occurrence of more than one red flag is likely for trade transactions involving ML. The red flags enumerated in this Chapter are by no means exhaustive. Annexure A to this Paper has enlisted 'red flags' from a number of sources. The process of developing red flags is continuous and requires more and more jurisdictions to contribute towards a common pool of knowledge.

## **CHAPTER III - TRADE FINANCE**

### **SIGNIFICANCE OF TBML**

143. TBML provides an important avenue for disguising funds of illicit origin and for moving value to finance illegal activities. Chapter II on Statistical Analysis may have failed to show the extent and prevalence of TBML in terms of statistical results. However, the significance of TBML as a means of moving illicit value across the globe cannot be denied.
144. Baker (2005: 25) has argued that because ‘anything that can be priced can be mispriced’ and ‘false pricing is done every day, in every jurisdiction, on a large percentage of import and export transactions’ that TBML ‘is the most commonly used technique for generating and transferring dirty money—money that breaks laws in its origin, movement and use’.
145. Preliminary examination of this statement would invoke acceptance by most AML practitioners as anecdotal evidence indicates that false pricing (under and over invoicing) is considerably widespread. It is considered by the project team to be particularly prevalent in trade within jurisdiction as a means of generating criminal wealth through deliberate avoidance of taxation commitments. This is one of the reasons why domestic trade is not within scope of this paper.
146. The project team believe that the geneses of TBML was to defeat the ability of jurisdictions to collect appropriate revenue as espoused by Baker but in more modern times, under and over invoicing has in fact become a ‘by-product’ of what has been identified as professional ML schemes involving very complex international TBML structures capable of moving billions of dollars of value with impunity. In these instances, the commodity is as good as cash without the governance currently imposed on cash transactions around the world. Why this can be achieved is also because of the fundamental lack of regulation of Trade internationally which provides the money launderer with ample vulnerabilities to exploit.
147. Using the cover of Trade is the most logical next step as it further frustrates the activities of regulators and investigators due to the sheer size of the trade mechanisms worldwide and the continuing introduction of new products to reduce supply line costs. The vast number of trade transactions produces a high level of ‘noise’ about the level of legitimate trade and increased flexibility of the processes masks the criminal ML activity. Without specific information to help focus investigations, automatic monitoring becomes relatively ineffective. Legitimate Trade structures have a significant number of benefits to professional ML syndicates namely:
  - The large amount of value that is moved internationally in the guise of Trade;
  - The appetite of jurisdictions especially those that are developing economies to promote trade which in turn reduces red tape to create corporate entities;
  - The ability to mask true activity of corporate entities and ability to disburse concentrations of illegal currency through corporate entities disguised as ‘business as usual’;
  - The ability to engage in corrupt practices on the pretense of trade and trade negotiation;

- The existing trade based mechanism including ‘Trade financing’, International trade payments in foreign exchange; trade liberalisation, electronic commerce and other financial markets are susceptible to abuse;
  - Lack of international regulatory coordination;
  - Lack of data matching across sovereign states;
  - Inconsistent legal frameworks; and
  - Enhanced electronic communication.
148. Unlike alternate remitters systems that are very mobile and operate on very small overheads, TBML structures, especially those that move large amounts of value, are expensive to create, expensive to maintain, leave a considerable evidentiary trail and are difficult to dismantle. It is for these reasons that those responsible for their creation leverage as much criminal profits as they can. These same structures can be used to:
- Launder criminal profits and instruments of crime from criminal activity other than tax evasion and fraud;
  - Undertake large fraud;
  - Facilitate confidence and other financial scams;
  - Facilitate corruption payments; and,
  - Siphon money from aid and other Government assistance programs.
149. Each can be undertaken as an individual activity or simultaneously if necessary. For this reason the project team see TBML as the most difficult activity to detect and in turn successfully disrupt and dismantle.
150. Further, professional money launderers do not need to utilise the traditional financing mechanisms used in International trade (for example credit documentation) as they are moving excess value (profit) or financing ongoing criminal activity (instrument of crime) and credit is not essential. They do so however, to further disguise their activity. The application of credit facilities also assist the criminals to defray their risk if it happens that their activities are detected as the credit partner has a legal right to at least some share of the funds that might be restrained for possible forfeiture.

## **THE TRADE FINANCE ENVIRONMENT**

151. In order to better understand how TBML operates it is necessary to understand the environment in which it operates. By understanding this environment, the ML investigator can better recognise the ‘red flags’ that help peel away the veneer considered paramount by money launderers in achieving their goals. With this veneer in place, an investigator is unlikely to recognise TBML as a result of all the ‘noise’ of legitimate trade. As stated, this paper attempts to provide investigators and in turn regulators with the insight to enable them to ‘crack’ that veneer.



152. Occurrence of trade in a Cash Based Economy can also open up possibilities for TBML which may throw up challenges of its own kind. The contribution by Nepal in the box item placed below give succinct description of such challenges.

### **CASH BASED ECONOMIES**

Less developed countries have economies which are largely cash based. These countries also usually have manual system of records. Such records lying with different entities are in a fragmented state and are usually un-reconciled. Discreet access to such records becomes impossible. These two features viz. Pre-dominance of cash transaction and manual record keeping pose many challenges in combating financial crimes as it is difficult to follow the paper trail. Cash based economies flourish in an economic environment which has a limited number of financial institutions in the formal financial sector. This situation makes the economy vulnerable to a number of financial crimes, including TBML.

Predominance of cash transactions builds uncertainty in the financial system. Transactions in cash allow for concealment of the true value of a transactions and/or the misrepresentation of true records. Cash transactions may even facilitate cash smuggling. Such transactions also fuel the underground economy and tax evasion.

The manual system of records engenders its own set of problems. There is difficulty in data collection. The data cannot be easily cross-checked, timely review of information is not possible and identification of any ultimate beneficiaries or ultimate suppliers and recipients becomes rather difficult. Without a proper database, the customs authorities in these countries also have a major handicap in detecting and investigating TBML cases.

The economic scenario is further compounded by the use of Alternate Remittance Systems (hawala / hundi) by workers of such countries who are located abroad and need to send their savings back home. Such an environment is quite conducive to TBML where proceeds of crime can be very easily structured as remittance for import/export and presented as legitimate funds.

153. It has been said that *trade finance* can be seen as the precise science of managing the capital required for Trade to flow. This chapter describes the most common of the Trade Financing Instruments used today in legitimate trade transactions and then attempt to identify the vulnerabilities of each of these.
154. In its simplest form, an exporter and importer enter into an agreement to Trade. This may be done in some developing regions by way of ‘countertrade’ but more often than not, it is achieved by way of a cash payment or some more complex form of financing.
155. Traders require working capital (i.e., short-term financing) to support their trading activities. Exporters will usually require financing to process or manufacture products for the export market before receiving payment. Such financing is known as *pre-shipping finance*. Conversely, importers will need a line of credit to buy goods overseas and sell them in the domestic market before paying for imports. In most cases, foreign buyers expect to pay only when goods arrive, or later still if possible, but certainly not in advance. They prefer an open account, or at least a delayed payment arrangement. Being able to offer attractive payments term to buyers is often crucial in getting a contract and requires access to financing for exporters.<sup>14</sup>

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<sup>14</sup> [Trade Facilitation Handbook for the Greater Mekong Subregion – Chapter 8: An introduction to Trade Finance](#)

156. The absence of an adequate trade finance infrastructure is, in effect, equivalent to a barrier to trade. Limited access to financing, high costs, and lack of insurance or guarantees are likely to hinder the trade and export potential of an economy, and particularly that of small and medium sized enterprises. Trade facilitation aims at reducing transaction cost and time by streamlining trade procedures and processes. One of the most important challenges for traders involved in a transaction is to secure financing so that the transaction may actually take place. The faster and easier the process of financing an international transaction, the more trade will be facilitated.<sup>15</sup>
157. Financial institutions play the critical role in trade finance. The trade finance products elaborated in this chapter are all derived from financial institutions. Financial institutions have a role to play in efforts to prevent ML activity, holding a large amount of intelligence and information critical for TBML investigators. Often however, these institutions are not aware of how critical the information they hold may be to an investigator. Close interaction with financial institutions is seen by the project team as fundamental to success in dismantling TBML structures.
158. The role of Government in *trade financing* is crucial especially in emerging economies. In the presence of underdeveloped financial and money markets, traders have restricted access to financing. Governments can either play a direct role like direct provision of trade finance or credit guarantees; or indirectly by facilitating the formation of trade financing enterprises.

## **INSTRUMENTS OF TRADE FINANCE & THEIR VULNERABILITIES**

### ***Bills of Exchange***

159. The drawing of a 'bill of exchange' (also referred to as a 'draft') is commonly used by exporters as a means of obtaining payment from buyers for goods shipped. Bills of exchange protects (reduces transactional risk) of both parties. Documentary credits (discussed later) issued for buyers by banks usually require bills of exchange to be drawn, and frequently bills of exchange are drawn by the seller in terms of the commercial contract of sale with the buyer.
160. The relevant financial institution has a vested interest in this transaction, as they are advancing credit to the buyer; and, given this advanced credit may be considerable in monetary terms, the due diligence by the institution is usually as comprehensive as is possible given the circumstances.
161. The Draft or Bill of Exchange (not always required) provides formal evidence of debt under a letter of credit and is presented with all other documents unless stipulated otherwise. A Draft may contain information on:
- Value of Draft, date of payment and payment terms e.g. "at sight", "30 days after sight", "60 days after Bill of Lading Date".

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<sup>15</sup> ([http://www.unescap.org/tid/publication/chap8\\_2224.pdf](http://www.unescap.org/tid/publication/chap8_2224.pdf))

- Date Exporter presents documents to the "available with" Bank (not normally required).
  - Letter of credit reference number assigned by the Issuing Bank (if required by credit).
  - Date the letter of credit was issued (not normally found on a draft).
  - Name and address of the Issuing Bank (if the drafts are drawn on the issuing bank).
  - Name and address of the bank on which the Drafts are to be drawn.
  - Signature of an authorised signing officer of the Company and the Beneficiary's name as shown on the letter of credit.
162. The *Commercial Invoice* is the accounting document through which the exporter charges the importer for goods and services purchased. The Invoice gives details about:
- Merchandise weight, quantity and price and currency.
  - The name and address of Exporter and the Importer.
  - The number of copies presented and signed if required.
  - The trade term listed, e.g. C.I.F., F.O.B etc.
163. The *Transport Document* (or Bill of Lading, Airway Bill, Railway Consignment Note) is a document issued by the carrier that describes the goods that have been accepted for carriage. In some forms, the Bill of Lading may also act as a document of title to the goods and should include information that is consistent with the letter of credit:
- Information on the merchandise (usually a general description).
  - The points of loading and discharge.
  - To whom the Bill of Lading is consigned.
  - The date of shipment.
164. The *Insurance Document* is a guarantee in part or in whole (depending on the terms and conditions) by an insurance company, specifying the goods shipped on a named vessel, indicating the applicable coverage, and showing to whom loss is payable.
165. The *Certificate of Origin* notes the country where the goods were produced. The *Certificate of Inspection* offers an opinion that the specified quality and quantity related conditions have been met. These documents should be dated on or before the Bill of Lading date.
166. A *Packing List* is usually supplied by the exporting shipper in cases where a diversified shipment is packed in several packages or containers. The list will show the contents of each box or case identified by a specific number. A *Weight Certificate* is supplied by the Exporter, at the request of the Importer. It certifies the weight of each large unit in a shipment or the net and gross weights of packages containing smaller units. It is of

particular value when the price of the goods is based on weight and, also, is often used by the carrier in arriving at the weight to be recorded on the Bill of Lading as a basis for the freight charges.

167. The quantity of units/weights should match the Commercial Invoice (this may or may not agree based on how the weights are calculated by the various parties involved). The breakdown of merchandise/weight per carton, package or container should be shown if requested in the letter of credit.

*Vulnerabilities:*

- Undertaken and paid for without any form of due diligence by an intermediary in the supply chain because the parties are complicit.
- Phantom trades maybe the cause of unrealistic timeframes or unrealistically short supply chains.

*Countertrade*

168. Countertrade exists where economies face the problem of limited foreign exchange holdings. That is, they do not hold enough currency of the jurisdiction they are trading with to pay the outstanding debt and the cost of buying more foreign currency to service that debt makes the trade uneconomical.

169. One way to overcome this constraint is to promote and encourage countertrade. It generally encompasses the idea of subjecting the agreement to purchase goods or services to an undertaking by the supplier to take on a compensating obligation in lieu of a cash settlement. The seller is required to accept goods or other instruments of trade in partial or whole payment for its products. Some of the forms of counter trade include:

- Barter – This traditional type of countertrade involving the exchange of goods and services against other goods and services of equivalent value, with no monetary exchange between exporter and importer.
- Counter purchase – The exporter undertakes to buy goods from the importer or from a company nominated by the importer, or agrees to arrange for the purchase by a third party. The value of the counter-purchased goods is an agreed percentage of the prices of the goods originally exported.
- Buy-back – The exporter of heavy equipment agrees to accept products manufactured by the importer of the equipment as payment.

*Vulnerabilities*

- The TBML vulnerabilities arise in determination of exchange ratios for the goods to be countertraded. Such ratios may often be determined as a process of negotiation rather than market determined, giving scope to TBML.

### *Documentary Credit (Letters of Credit, etc)*

170. Generally the exporter requires an importer to prepay in cash for goods shipped. The importer naturally wants to reduce risk by asking the exporter to acknowledge through documents that the goods have been shipped. The importer's bank assists by providing a letter of Credit (Documentary credits) to the exporter (or the exporter's bank) providing for payment upon presentation of certain documents, such as a bill of lading, either immediately or at a prescribed date.
171. A letter of credit is a precise document whereby the importer's bank extends credit to the importer and assumes responsibility in paying the exporter. Aside from the letter of credit document, other documents used in legitimate Trade include shipping and insurance documents, and commercial invoices. The documentary credit arrangement offers an internationally recognised and used method of attaining a commercially acceptable undertaking by providing for payment to be made against presentation of documentation representing the goods, making possible the transfer of title to those goods.
172. Documentary credits (LCs, etc) are seen as a declining method of doing business, although small and medium enterprises often rely upon documentary credit basis for trade finance. Trade finance has been shifting away from this sometimes cumbersome and often expensive method of conducting business to that conducted on an open account basis.

#### *Vulnerabilities*

- Even in this simple form the true value of goods transferred between countries can be masked through misrepresentation of price, quantity and quality. Letters of Credit may be generated to create a veneer.
- The documentation generated in the process leaves a paper trail which money launderer may rely upon to disguise illegal proceeds.

#### *Open Account Facilities*

173. Open account transactions can be described as 'buy now, pay later' and are more like regular payments for a continuing flow of goods rather than specific transactions. The pursuit of 'supply chain efficiencies' among larger businesses has encouraged their preference for open account trading, even as small and medium enterprises still rely upon documentary credit basis to conduct business of international trade. Ultimately these results suggest that trade finance should be flexible and that financiers will benefit by adapting product and service offerings to the needs of customers in different segments.<sup>16</sup>

#### *Vulnerabilities*

- Open account facilities have caused a disconnect between the movement of the underlying trade and the money used to finance it.

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<sup>16</sup> <http://www.east.com.au/media/2009-09-16.pdf>

- Payments against these facilities may or may not be undertaken through an international funds transfer instruction (IFTI) or SWIFT.

174. A range of Open Account Facilities are set out below.

### ***Factoring***

175. Factoring, also known as invoice discounting, receivables factoring or debtor financing, is where a third party company assumes a debt or invoice from another company. This involves either the sale at a discount of accounts receivable or other debt assets on a daily, weekly or monthly basis in exchange for immediate cash. It can also involve the charging of interest on the debt. The debt assets are sold by the exporter at a discount to a factoring house, which thereby assumes part of risks of the account receivable. Factoring in international trade is the discounting of a short-term receivable (up to 180 days). The exporter transfers title to its short-term foreign accounts receivable to a factoring house for cash at a discount from the face value. It allows an exporter to ship on open account as the factor assumes the financial liability of the importer to pay and handles collections on the receivables. The factoring house usually works with consumer goods.

176. Factoring therefore relieves the first party of a debt for less than the total amount providing them with working capital to continue trading, while the buyer, or factor, chases up the debt for the full amount and profits when it is paid. The factor is required to pay additional fees, typically a small percentage, once the debt has been settled. The factor may also offer a discount to the indebted party. Essentially factoring transfers the ownership of accounts to another party that then chases up the debt. In the absence of private sector players, Governments can facilitate the establishment of a state-owned factor; or a joint venture set-up with several banks and trading enterprises. The peak international body is Factors Chain International (FCI) which is a body that International Factors deal with<sup>17</sup>.

177. Factoring is divided into import factoring and export factoring. Details of each are set out below.

### ***Export factoring***

178. In export factoring, the Factor deals directly with the seller of the goods. In this case the debt is a 'recourse' debt, and if the seller goes under, or the purchaser does not pay, the local Factor assumes the risk. In Export factoring the local Factor, deals with a counterparty Factor, who will check out the creditworthiness of the purchaser.

179. In this case the seller will provide documentation to show that the goods have been shipped prior to payment. Payment is usually made on an 80/20 split, 80% is paid to the seller at the time of the invoice/goods shipment. This amount is loaned to the seller by the Factor and interest charged until the purchaser pays. When the purchaser pays the 100% of the invoice

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<sup>17</sup> <http://www.fci.nl/about-factoring/how-does-it-work>

the Factor pays the seller the other 20% of the invoice. There is usually a small activity fee (around 1% of the invoice that is also charged, so it is typically a 80/1/19 split!)

### ***Import Factoring***

180. Import factoring is a reverse of the scenario set out for export factoring, but differs slightly. The local Factor will insure the risk on a usually 80% basis, and will therefore carry a 20% risk. This is called a 'non-recourse debt'. The local Factor will check out the bona fide credit history etc. of the purchaser of the goods. Credit lines etc are usually established.
181. The foreign factor will examine the bills of lading shipping documents etc and confirm with the Local Factor. International factoring (as opposed to domestic factoring) have more to do with the counterpart abroad and with insuring risk.

### ***Vulnerabilities***

- Often the factor may be left with losses after the so-called traders disappear, after having indulged in TBML, by moving illicit funds through 'sham trade'.

### ***Forfaiting***

182. Forfaiting is the purchase of an exporter's receivables (the amount importers owe the exporter) at a discount by paying cash. The purchaser of the receivables, or forfaiter, must now be paid by the importer to settle the debt. As the receivables are usually guaranteed by the importer's bank, the forfaiter frees the exporter from the risk of non-payment by the importer. The receivables have then become a form of debt instrument that can be sold on the secondary market as bills of exchange or promissory notes. Forfaiting is a method of trade financing that allows the exporter to sell its medium-term receivables (180 days to 7 years) to the forfaiter at a discount, in exchange for cash. With this method, the forfaiter assumes all the risks, enabling the exporter to extend open account terms and incorporate the discount into the selling price. Forfaiters usually work with capital goods, and large projects.

### ***Vulnerabilities***

- These instruments (exporter's receivables) are capable of being sold on the secondary market as 'bills of exchange' or 'promissory notes', provides a money launderer with an enhanced mechanism to move value.
- If the launderer, through collaboration inflates the value of receivables more value can be moved.

### ***Pre-Shipment Finance***

183. This is financing for the period prior to the shipment of goods, to support pre-export activities like wages and other costs. It is especially needed when inputs for production must be imported. It also provides additional working capital for the exporter. Pre-shipment financing is especially important to smaller enterprises because the international sales cycle

is usually longer than the domestic sales cycle. Pre-shipment financing can take the form of short-term loans, overdrafts and cash credits.

#### *Vulnerabilities*

- Pre-shipment finance especially its application to 'inputs for production that must be imported' provides the money launderer with an ability to engage a third party in another jurisdiction thus moving value to all venues in which the criminal syndicate are operating and thus widen the scope for TBML.
- Short-term loans, overdrafts and cash credits may allow launderers to make business claims on the relevant revenue agencies in those countries thus supplementing their reasons for the value they hold.

#### ***Post-Shipment Finance***

184. This is financing for the period following shipment. The ability to be competitive often depends on the trader's credit term offered to buyers. Post-shipment financing ensures adequate liquidity until the purchaser receives the products and the exporter receives payment. Post-shipment financing is usually short-term.

#### *Vulnerabilities*

- Although this method of financing is short term by nature, cash is usually supplied at time of sale, hence such pretence would not raise suspicion unless intelligence arouse such suspicion.

#### ***Buyer's Credit***

185. A financial arrangement whereby a financial institution in the exporting jurisdiction extends a loan directly or indirectly to a foreign buyer to finance the purchase of goods and services from the exporting jurisdiction. This arrangement enables the buyer to make payments due to the supplier under the contract.

#### *Vulnerabilities*

- Financing of the importer by an institution in the exporter's jurisdiction widen the scope for TBML, since to exercise due diligence in a foreign jurisdiction may be more difficult.
- The money launderers seek this credit to help minimise risk of confiscation.
- If a financial institution has a stake in the trade, law enforcement has to account for that stake in any ensuing action unless the law enforcement action can demonstrate that the financial institution is complicit.

#### ***Supplier's Credit***

186. A financing arrangement under which an exporter extends credit to the buyer in the importing jurisdiction to finance the buyer's purchases.



### *Vulnerabilities*

- The utilisation of *Supplier's Credit* arrangements provide a mechanism to move significant amounts of value in most forms irrespective of whether or not the trade is legitimate, inflated or phantom.
- This financing arrangement need not involve a financial institution, although to reinforce the veneer, engaging the third party may be undertaken in ML schemes.
- If the buyer and seller are in collusion, this mechanism is a channel for TBML.

### *Structured Commodity Finance*

187. Structured commodity finance (SCF) focuses on three main commodity groups: metals & mining, energy, and soft commodities (agricultural crops). It is a financing technique utilised by commodity producers and trading companies conducting business in the emerging markets. SCF provides liquidity management and risk mitigation for the production, purchase and sale of commodities and materials. This is done by isolating assets, which have relatively predictable cash flow attached to them so as to estimate their present value. The corporate borrowers use such assets to mitigate risk and secure credit from a lender. A corporate therefore borrows against a commodity's expected worth.
188. If all processes go to plan, then the lender is reimbursed through the sale of the assets. If not then the lender has recourse to some or all of the assets. Lenders charge interest on any funds disbursed as well as fees for arranging the transaction. SCF funding techniques include those techniques previously mentioned, namely, pre-export finance, countertrade, barter, and inventory finance. These solutions can be applied across part or all of the commodity trade value chain: from producer to distributor to processor, and the physical traders who buy and deliver commodities.
189. As a financing technique based on performance risk, it is particularly well-suited for emerging markets considered as higher risk environments.<sup>18</sup>

### **USEFUL TIPS FOR TBML INVESTIGATORS**

190. Whilst it is suggested that trade financing and especially open account facilities can provide a reasonable veneer for the activities of the money launderer, it is still costly to set up and maintain. It is important to emphasise that if the veneer protecting the criminal mischief is cracked the trail is relatively easy to follow. In conducting Trade business, legitimate companies also require mechanisms to track their activity and example of this include:

### *Export Credit Insurance*

191. In addition to financing issues, traders are also subject to risks, which can be either commercial or political. Commercial risk arises from factors like the non-acceptance of goods by buyer, the failure of buyer to pay debt, and the failure of foreign banks to honour

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<sup>18</sup> <http://www.tradefinancemagazine.com/boutUs/tub/WhatIsTradeFinance.html>

documentary credits. Political risk arises from factors like war, riots and civil commotion, blockage of foreign exchange transfers and currency devaluation. Export credit insurance involves insuring exporters against such risks. Export Credit Insurance is not likely to be something of interest to either the professional or novice money launderer as it adds additional costs seen as unnecessary and therefore should be something actively examined by the TBML investigator.

### ***Trade Services Utility***

192. In response to the development of open account trading, the organisation SWIFT launched the TSU (trade services utility), a collaborative centralised data matching utility, which allows banks to build products around its core functionality to improve the speed and flow of open account trade. This is helping banks re-intermediate themselves into these trade flows.
193. This development may in fact be of assistance to TBML investigators as it can help identify 'red flags' discussed in this paper. There are a number of other mechanisms capable of collecting data including revenue departments, customs departments, accountancy data, general financial data, market data, topography data and social media data. The issue to date when it comes to investigating and prosecuting TBML is that this data is still stored in a dispersed way.
194. TBML investigator will need to devise ways in which to gather this data, have it integrated and then analysed against the concept of time and distance and normality. It is only then will enough criminal activity will be identified and actioned to cause a change in general attitude which is all that can be expected.
195. The project team believes that two critical elements that might be used to crack the veneer created by the ML syndicates is for investigators to consider the concepts of time and distance in ML schemes. Investigators need to commence building a time line of all known events surrounding the activities of the syndicates being investigated. Information and intelligence gathering is paramount to this endeavour and interaction with the financial institution is essential. These institutions have a vested interest in ensuring the trade in which they are engaged is legitimate. These discussions may be hampered by domestic privacy restrictions so legislative change may be necessary before significant headway can be made.
196. Distance is the other key concept. Inconsistencies in documentation, excessive complication and unrealistic time frames all contradict that path of least resistance and should therefore raise suspicion.

### ***Partnership with Private Sector***

197. An outreach programme can help create awareness about the TBML vulnerabilities to which private business are exposed. Not only the private sector can install preventative measures but in turn disseminate useful information for the ML investigators. U.S. Immigration and Customs Enforcement (ICE) have introduced many new initiatives aimed

at analysing and combating the movement of illicit funds by bulk cash smuggling, TBML, courier hubs, money services businesses (MSBs), charities, and alternative remittance systems. These initiatives include:

- Operation Cornerstone, (founded in 2003 – a private industry partnership and aggressive outreach program) (<http://www.ice.gov/cornerstone/>).
- Operation Cornerstone detects and closes down weaknesses within U.S. financial, trade and transportation sectors that can be exploited by criminal networks. Law enforcement entities share criminal typologies and methods with businesses and industries that manage the very systems that terrorists and criminal organizations seek to exploit. This sharing of information allows the financial and trade community to take precautions to protect itself from exploitation. In return, ICE receives information to more thoroughly investigate these complex and sophisticated criminal schemes.

### *Inter-sectoral & cross border transaction data analysis*

198. Cross referencing of trade data with that of trade finance is useful to discover trade anomalies which can in turn lead to TBML investigations. It is important that such anomalies are investigated in the light of information obtained from international trading partners. In 2004, the US ICE established a number of Trade Transparency Units (<http://www.ice.gov/trade-transparency/>) to combat TBML and other import–export crimes. These TTUs rely on data analysis of international trade patterns to identify potential TBML activities. The TTUs in the United States use the ‘Data Analysis and Research for Trade Transparency Systems’ (DARTTS), which allows investigators to view totals for merchandise imports and then sort on any number of variables, such as jurisdiction of origin, importer name, manufacturer name, and total value (US DHS 2010: 3). Through this, DARTTS identifies trade and financial transactions that are ‘statistically anomalous based on known facts and user queries’, rather than being used to ‘predict future behaviour’ or to ‘profile’ traders (US DHS 2010: 3) The data that DARTTS uses is collected from US Customs, the US Bureau of Census (where historical trade data is held), FinCEN and foreign government bodies, and consists of information gathered from those required to complete import–export forms (US DHS 2010). From this collection of data, three types of analysis are conducted by DARTTS:

- *International Trade Discrepancy Analysis* — US and foreign import/export data are compared to identify anomalies and discrepancies that warrant further investigation for potential fraud or other illegal activity.
- *Unit Price Analysis* — trade pricing data are analysed to identify over- or under-valuation of goods, which may be an indicator of TBML or other import–export crimes.
- *Financial Data Analysis* — financial reporting data (the import/ export of currency, deposits of currency in financial institutions, reports of suspicious financial activities and the identities of parties to these transactions) are analysed to identify patterns of activity that may indicate illegal ML schemes (US DHS 2010: 110).

199. When conducting this analysis, the TTU in the United States relies heavily upon information gathered from other countries.

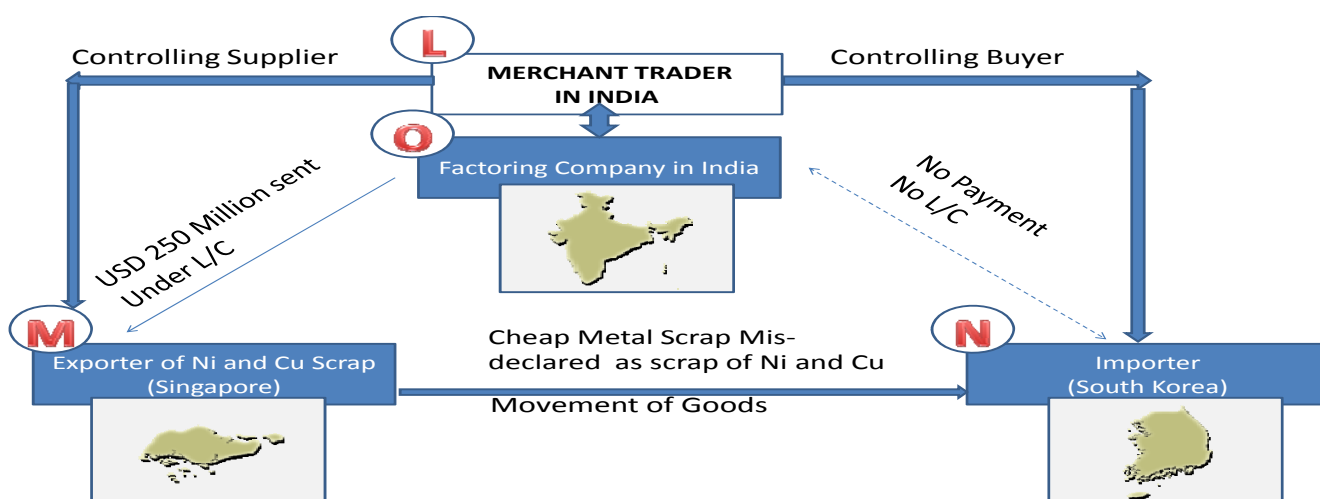
## **CHAPTER IV - CASE STUDIES**

200. Case studies best illustrate the complex and simple forms of TBML. The cases studies set out below, while being based upon the experience of various jurisdictions, present the facts in simplified manner, through narration and diagram, highlighting the modus operandi and red flags.
201. The FATF Paper 2006 on the TBML focused on trade based techniques used in TBML. The techniques which have been mentioned are over/under invoicing of goods, multiple invoicing of goods, over/under shipments of goods and false description of goods. Besides identifying these elements of trade that facilitate TBML, the seven case studies presented in this Chapter also bring-out the mechanisms of trade finance used in TBML.
202. The cases studies have been presented in four parts. The first part comprises the modus operandi in several simple steps. The second part demonstrates the essence of modus operandi though a diagram. The third part relates to giving comments on the case study so as to highlight the essential features. Finally, a list of red flags which can be inferred from the case study is included.

### **CASE STUDY 1 (Information provided by India)**

- Company L located in India entered into a trade arrangement called merchanting trade with Company M located in Singapore and Company N located in South Korea.
- Trade arrangement required that Company L act as an intermediary between Company M and Company N.
- Trade finance arrangements required Company L to make payments to Company M and receive payments from Company N.
- Goods involved in the transaction i.e. “Nickel & Copper Scrap” were to be directly shipped from Company M to Company N.
- To secure payment for Company M, Company L got Letters of Credit (L/C) issued in favour of Company M (import leg).
- Company L entered into an agreement with Company O in India to get such Letters of Credit issued by Company O in favour of Company M for a charge of commission by Company O (for the import leg of the transaction).
- Company O secured receipt of payments for the export leg of the transaction (payment from company N) by obtaining bonds and guarantees furnished by Company L.
- On the advice of Company L, Company O opened L/Cs in favour of Company M as & when Company M directly shipped scrap consignments to Company N.
- Company M on shipment of the goods to Company N, got such Letters of Credit discounted with the bank.

- For the initial shipments, Company N accepted the goods and made payments to Company L. For payments made through Letters of Credit by Company O to Company M, Company L compensated Company O through payments received from Company N.
- After the successful completion of the initial rounds of transactions, Company N defaulted on payments to Company L even though the Letters of Credit opened by Company O to Company M, Company L compensated Company O through payments received from Company N.
- The trade finance arrangement for the import leg of the transaction was completed between Company M & Company O by way of payment to beneficiary (Company M) but for the export leg of the transaction, due to non-acceptance of goods by Company N, no payment was received from Company N to Company O through Company L.
- On investigations it was found that Company L was in league with Company M & Company N. Company O was left with heavy losses.
- Predicate offences of cheating and criminal conspiracy were involved and merchanting trade and its finance arrangements were used to launder the criminal proceeds.



### Commentary:

203. This case study reveals the misuse of trade and trade finance to generate proceeds of crime and to launder funds. Unlike conventional methods of laundering the money in which generally, the proceeds of crime is structured into the financial system, in this case proceeds of crime were generated through mis-declaration of the goods, forgery of trade documents and the introduction of a third party in a jurisdiction other than the two trading countries. The techniques deployed to indulge in TBML were mis-declaration of goods and related party transactions which were not independent corporate structures.

204. In this case study, Letters of Credit (trade finance) were arranged only for the import leg of the transaction and not for the export leg. Thus trade finance mechanisms became

vulnerable to laundering the criminal proceeds. The lack of proper due diligence by the factoring company in assessing and acknowledging the risks and the lack of duty of care by banks in undertaking the proper scrutiny of the documents facilitated the commission of crime and TBML.

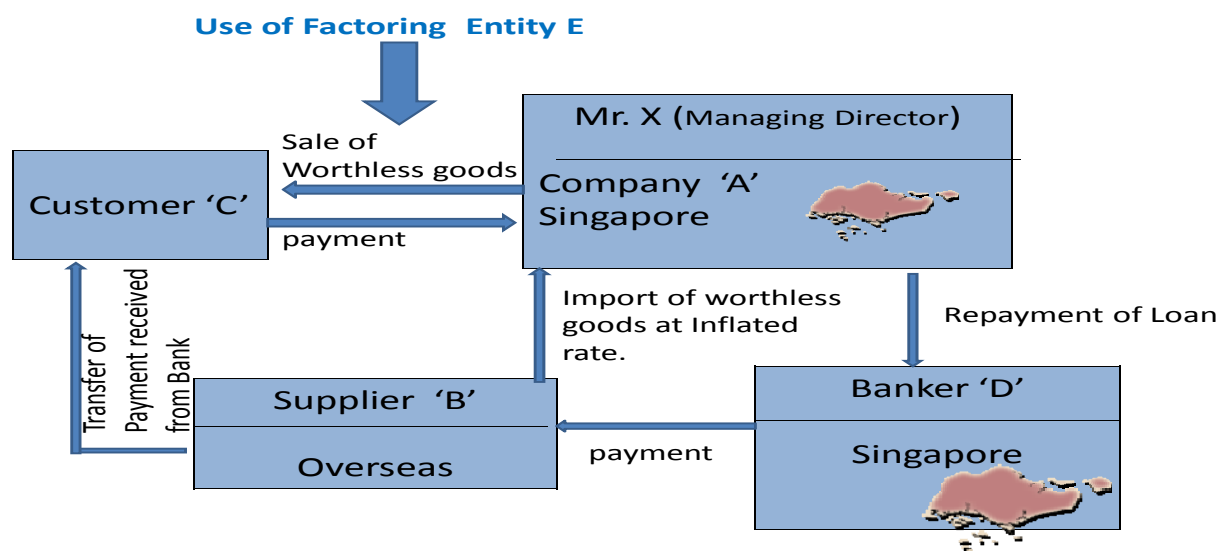
### **Red Flags**

1. Mis-declaration of the goods - both of quality and type.
2. The third party located in a third jurisdiction acted as an intermediary, even though goods were in fact capable of being supplied from one jurisdiction to another jurisdiction directly.
3. Both supplier and buyer of the goods are related to the intermediary or the buyer and /or the seller all belong to the same group of companies.
4. Risk exposure of the factoring company was not commensurate with expected norms.
5. Intermingling of different types of trade finance arrangements for different segments of trade transactions.

### **CASE STUDY 2 (Information provided by Singapore)**

- Mr X was the managing director of a Company A listed on a stock exchange outside Singapore. Company A indulged in trade of integrated circuit chips.
- In 2001, Company A began experiencing cash flow problems due to an industry downturn.
- Mr. X tied up with Supplier B located abroad and Customer C to collude in a fraudulent scheme.
- Overseas Supplier B supplied worthless goods to Company A and raised grossly inflated invoices.
- Company A submitted trade credit applications to Banker D for disbursing invoiced value to Supplier B.
- Supplier B then transferred the funds corresponding to the inflated value to Customer C.
- Company A then “sold” these worthless goods to Customer C again at inflated value.
- In order to realise the invoiced value of the goods “sold” to its accomplice Customer C before the expiry of the credit period, Company A discounted the invoices raised to Customer C with Factoring Entity E.
- The payment received by Company A was then used to repay the trade credit which it had obtained from its Banker D.
- The Customer C paid the factoring company when the credit term was due.
- Through this scheme, Company A and its accomplice suppliers and customers defrauded various banks and a factoring company into disbursing funds.
- Mr X was charged with cheating offences for his role in defrauding bankers and the factoring company.

- Mr. X had also exploited the international trade system to channelize the disbursements from Singapore back to Company A after a series of cross border sham purchases / sales involving the same worthless goods.



### Commentary:

205. In this case study, international trade was mis-used to fraudulently obtain funds from banks and from a factoring company and launder proceeds through trade channels. By resorting to cross-border transactions, it became easy to deceive the banks and the factoring company as it is generally difficult to verify the genuineness of the other end of the international trade transactions pipeline. Further, by using accomplice suppliers and accomplice customers, the entire movement of mis-declared goods was fully controlled by the main person Mr. X and thereby it escaped detection for six years. The trade finance channels of the bank, trade credit, open accounting and factoring were all used to circulate the funds.

### Red Flags

1. Mis-declaration of value (over-valuation) of goods.
2. Series of cross border transactions in the same goods between related companies.
3. Use of factoring companies to finance trade transactions between related companies.
4. Despite an industry-wide recession, the ability of a company to generate large funds from trade.
5. Direct payment through open accounting from banks to overseas suppliers on trade credit application of the domestic trader.

### **CASE STUDY 3 (Information provided by USA)**

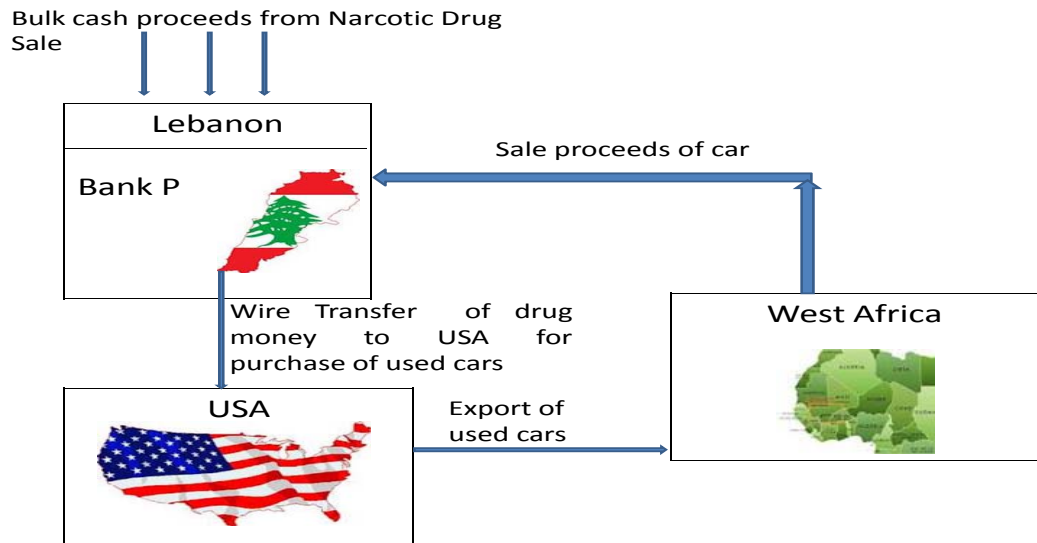
206. Authorities in US had information that Bank P in Lebanon had been extensively used by an international drug trafficking syndicate controlled by individual Q for moving the proceeds of narcotics sales through TBML across the globe.

- The syndicate smuggled narcotics from South America to Europe and to the Middle East through West Africa.
- The kingpin Q of the syndicate organised shipments of 100 Tonnes of Cocaine from South America and laundered the proceeds of up to US \$ 200 Million per month, obtained from the sale of cocaine in Europe and Middle East.
- Proceeds of drug trafficking were moved and laundered through-
  1. bulk cash smuggling (cash couriers) ;
  2. use of exchange houses including one owned by Q.
  3. use of accounts of family members of “Q” in several branches of Bank P ;
- Bulk cash deposits were made by Q and his associates into exchange houses which in turn deposited the money into several accounts maintained in Bank P.
- In fact Q owned and controlled one of the exchange houses located in the same building as a branch of Bank P. Certain employees of Bank P were in league with Q.
- Two distinct TBML schemes were used by the syndicate to move and launder illicit funds through trade.

#### **SCHEME A**

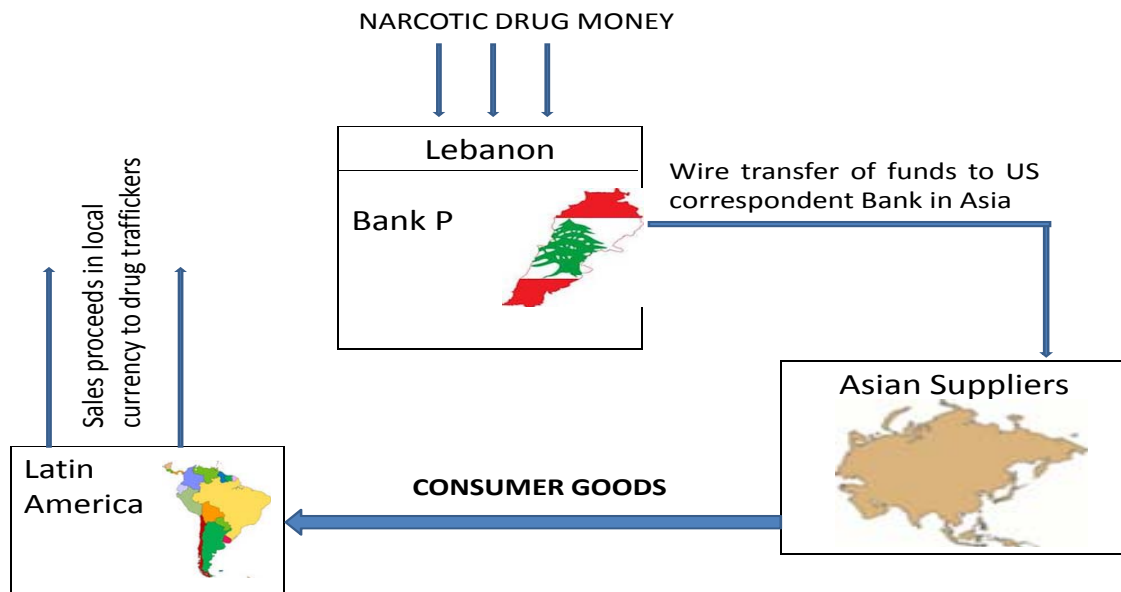
- In the first scheme, wire transfers from Bank P were sent to banks in U.S. for the purchase of used cars in the U.S.
- The car dealerships were operated by individuals who had been separately identified in drug-related investigations.
- The recipients of these funds purchased vehicles in the United States, which were then shipped to countries in West Africa and elsewhere.
- The proceeds generated from sale of used cars were ultimately repatriated back to Lebanon.
- The money generated from illicit drug trade was thus fully integrated into the financial system through TBML scheme involving trade in used cars.





## SCHEME B

- In the second scheme, Individual R, who owned a wide network of companies which were dealing in consumer goods in Asia and in other regions provided consumer goods for TBML.
- Although based in Asia, individual R had centralized his banking operations in Lebanon, particularly through the use of over 30 accounts at Bank P.
- Individual R received funds in his accounts from the kingpin Q and R also exchanged funds with the Latin American members of the drug syndicate.
- In the TBML scheme used by them, the proceeds generated in local currency from the sale of imported consumer goods were deposited in individuals' accounts in the local banks.
- This completed the Latin America-based Black Market Peso Exchange ML cycle, and allowed for the repatriation of proceeds for the Latin American drug producers.



### Commentary:

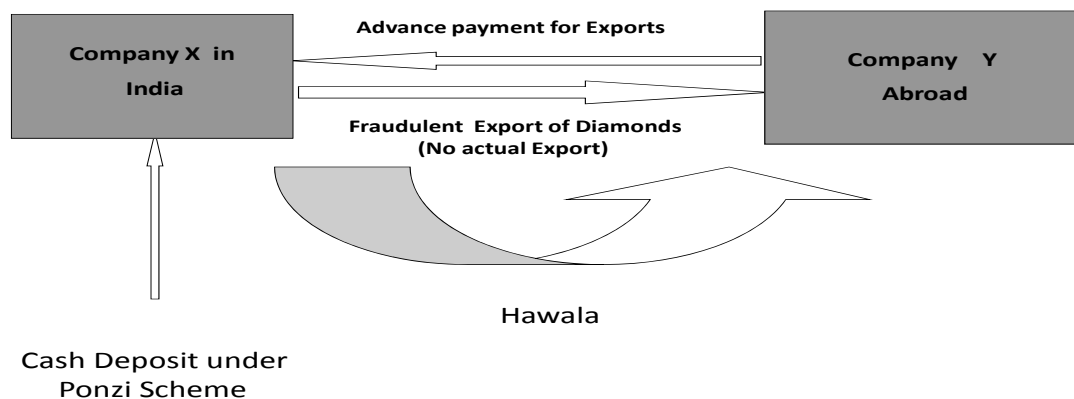
207. The proceeds of narcotics drug money were first placed into the financial system of a jurisdiction where the AML regime was not adequately strong. The syndicate targeted jurisdictions where the AML regime may not have been as strong as Europe. The criminal syndicate was able to influence individuals on the operations of its bank as well as those of the exchange houses. The proceeds of drugs was layered and moved through the use of international trade. Round tripping of the money and its laundering occurred through abuse of trade and trade finance (open accounting system). Interestingly, both the TBML schemes were being operated concurrently and funds were moving between the two schemes, by use of the Money Exchange House established by Q.

### Red flags

1. Trade in commodities like used cars and consumer goods for which valuation can be manipulated.
2. Payment for imports received from banks located in a third jurisdiction, whereas goods are traded between two other countries.
3. Cash deposits made in bulk in certain bank accounts from high risk customers like exchange houses.
4. Cross border wire transfers from sensitive jurisdictions without adequate explanation of the considerations involved for such transfers.

#### CASE STUDY 4 (Information provided by India)

208. Company X located in India received advance remittance from Company Y located in foreign jurisdiction for a promise to export consignments of diamonds.
- Company X filed falsely declared and forged documents with the bank to show the overvalued exports of diamond without having made any shipment.
  - To give a colour of authenticity, Company X also fabricated purchase invoices to show local purchases of diamonds, whereas no purchases of diamonds had actually ever taken place.
  - Company X received export payments through trade finance arrangements via an open accounting system from Company Y.
  - Company X had received substantial cash deposits in India from the public on the promise of high returns via a fraudulent Ponzi Scheme.
  - Company X transferred large amounts of public deposits to company Y through hawala (Alternative Remittance System).
  - Company X indulged in round tripping by receiving back as export earnings the financial value which it had transferred abroad as hawala.
  - Predicate offences of cheating, criminal conspiracy and forgery of documents occurred.



#### Commentary:

209. In this case, the proceeds of crime were generated through the fraud perpetrated on general public under a Ponzi scheme which was then laundered through fraudulent and bogus exports. Such proceeds of crime were transferred abroad through alternative remittance system. Money was received back from abroad through banking channels as export

remittance. Round tripping of money and its laundering occurred through TBML. Company X had a network of associate companies established in many jurisdictions abroad. In this case, on the trade side, overvaluation of export goods and under shipment (no shipment) of goods was done. Proceeds of Crime were moved abroad by using alternative remittance system (hawala) and then round tripping occurred through open accounting system.

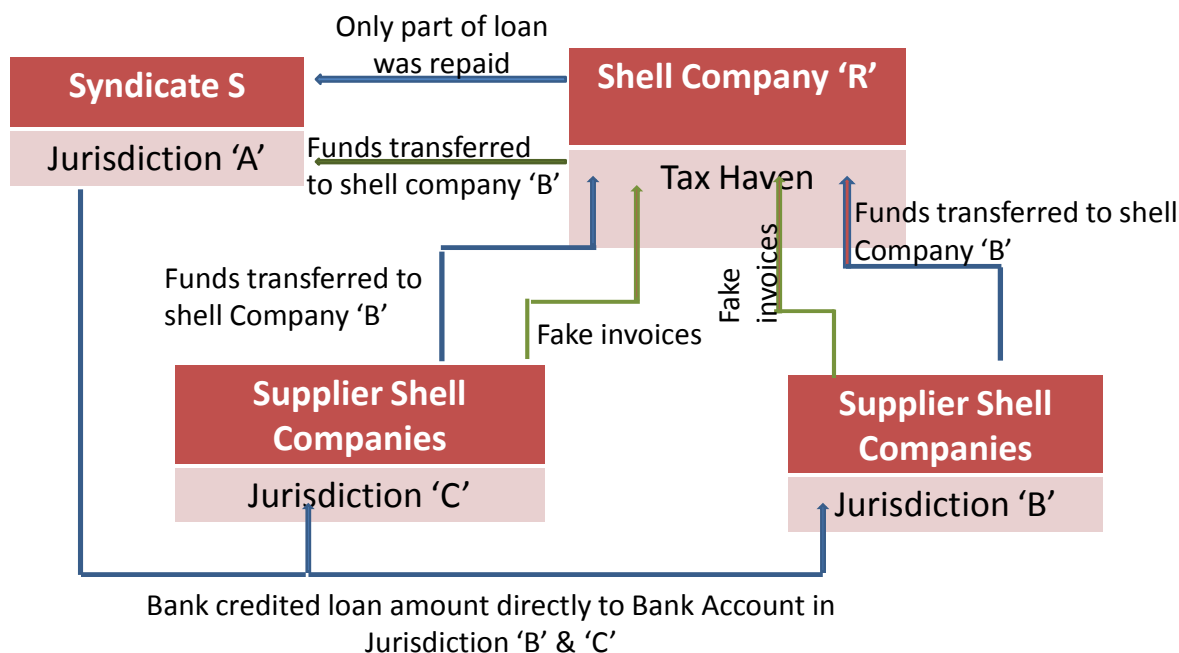
### **Red flags**

1. Export of goods without any corresponding purchase of raw materials or finished goods.
2. Sudden increase in volume of exports by a new exporter.
3. Advance inward remittance against exports without justifiable reasons.
4. Export documents which are not duly authenticated by export regulating agency were accepted by the bank.

### **CASE STUDY 5 (Information provided by Macao, China)**

210. Criminal Syndicate S had a regional base in Jurisdiction A.

- Syndicate S registered a Shell Company R in a tax haven jurisdiction.
- Syndicate S set up a number of “supplier” shell companies in Jurisdiction B and Jurisdiction C.
- Syndicate S opened accounts in more than 10 banks in Jurisdiction A and applied for high value loans.
- Shell Company R claimed that the company dealt with cross-border trading activities, and thus purchased goods from Supplier Companies in Jurisdiction B and in Jurisdiction C.
- Shell Company R obtained trade credit from the banks in Jurisdiction A on the strength of invoices for the purchases made from Jurisdictions B & C.
- The banks in Jurisdiction A directly credited loan amounts at the behest of Company R into the bank accounts of the “supplier” shell companies in Jurisdiction B and in Jurisdiction C.
- On receipt of funds the “supplier” shell companies immediately transferred the funds through a circuitous route to Shell Company R and to other accounts controlled by Syndicate S.
- Shell Company R used the funds for part repayment of loans.
- The fake transaction cycle engendered outstanding non-performing loans for banks in Jurisdiction A.



211. **Commentary:** In this case study, it is observed that cross border trade was mis-used by a criminal syndicate to move value between shell companies located in different jurisdictions. There was use of a Tax Haven jurisdiction to take advantage of relaxed AML regime and to avoid detection. The veneer of international trade was created to conceal collusion among related companies located in different jurisdictions. The trade finance mechanism of raising bank loans (trade credit) against fake invoices could occur due to limitations to verify the credibility of overseas suppliers. Wire transfers made to such related suppliers resulted in losses to banks. Thus a Criminal Syndicate could indulge in TBML in the absence of cross-verification of trade data and financial data.

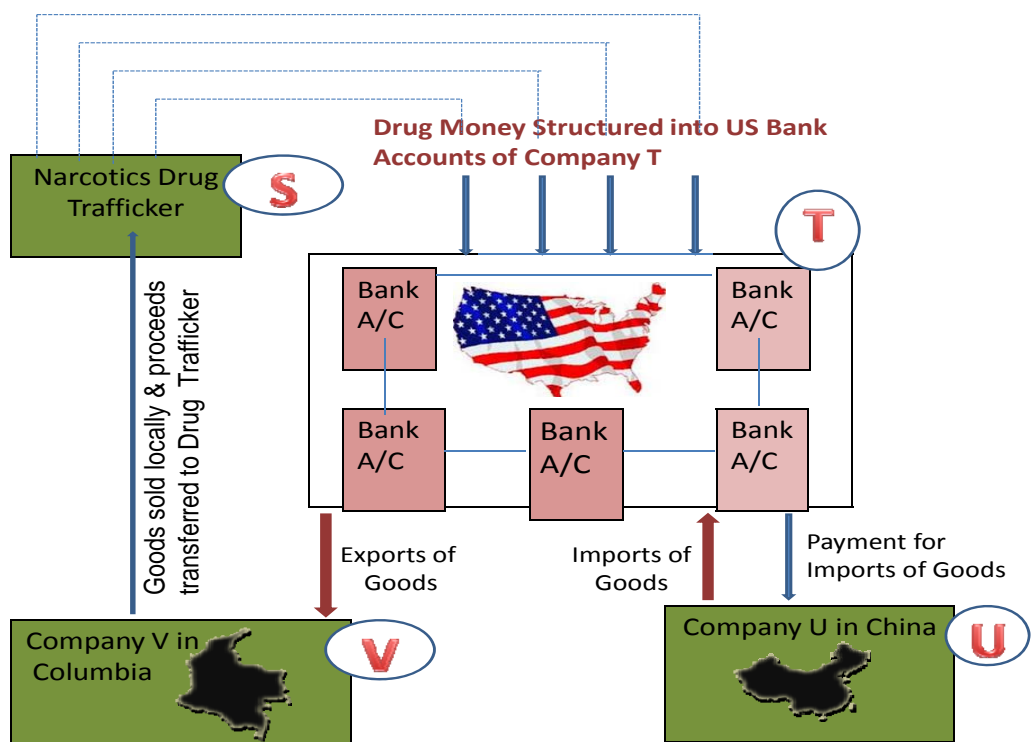
### Red Flags

1. Use of corporate structure of shell companies located across the jurisdictions.
2. Registration of a trading company in a tax haven even though its business relates to another jurisdiction.
3. Mismatch between trade documents like bill of lading, import bill, invoices and trade finance documents (trade credit applications).
4. Direct payments by banks to overseas suppliers who are related parties without adequate verification of the authenticity of such suppliers and without verifying trade transactions.

## **CASE STUDY 6 (Information provided by USA)**

212. Toy Company T of Los Angeles, USA was receiving cash generated from trafficking of narcotics by Columbian drug cartel S.

- Company T received such cash by two methods - in some cases, people affiliated with drug traffickers simply dropped cash at the company offices in downtown Los Angeles; the second method involved cash deposits made directly into Company's bank account, sometimes by individuals located as far away as New York.
- During the four-year period, the investigation tracked more than \$ 8 million in cash deposits into the accounts of the Company T, and not a single transaction was for more than \$ 10,000.
- The bank accounts of Company T, were used to pay for import of toys into USA.
- The toys, viz. stuffed animals, including teddy bears and Topo Gigio dolls, were imported from Company U in China.
- The toys imported into US from China were again exported from the U.S. to Company V in Colombia.
- The Colombian pesos generated by the sales of toys by Company V were then used to reimburse the Colombian drug trafficker.
- TTU Colombia was deployed to investigate shipments of toys.
- The TBML investigation brought out structuring transactions to avoid reporting requirements, bulk cash smuggling and intimidation of witnesses. In addition, the toy Company T was charged with conspiracy to launder money.
- Five persons, including two owners of the Company T and a Columbia-based businessman were convicted and fined.



**Commentary:**

213. Cash obtained from the trafficking of narcotics was first structured into financial system through smurfing. Money was then used to import toys, thereby converting the proceeds of narcotics trafficking into goods. The imported toys were then re-exported to move that value to the desired jurisdiction, in lieu of the value of narcotic drugs. Thus international trade was used for layering and integrating the crime money and to disguise its illicit origin.

**Red Flags**

1. Payment for import is made through multiple accounts.
2. Credits into such accounts were made mostly through structured cash deposits, i.e. through smurfing.
3. Re-export of goods to sensitive jurisdictions.
4. Inadequate consideration received for re-exported goods.

## **CASE STUDY 7 (Information provided by India)**

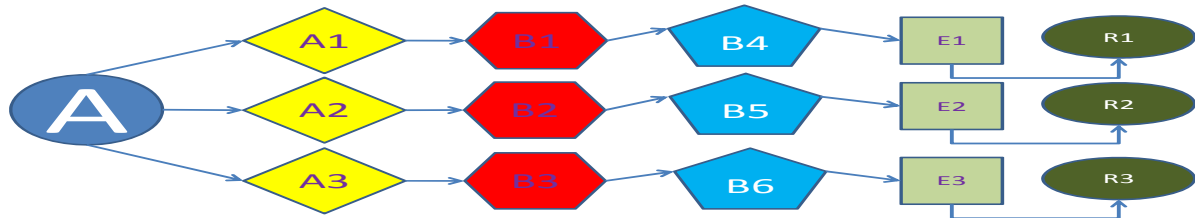
214. This is a complex case which involves multiple techniques of ML by misuse of trade as well as trade finance mechanisms. The kingpin of this ML racket, called “A” in this case study, was laundering funds for Narcotic Drug cartels in Asia and South America using various techniques including cash couriers, money service bureaus, alternate remittance system (hawala) as well as through formal mechanisms of trade finance.

### ***A. MISUSE OF LETTERS OF CREDIT (DOCUMENTARY CREDIT)***

- An Indian national “A” was based in Dubai and had established a number of companies there, say A1, A2, A3.
- He also had a network which spread across many countries in Europe, Asia, Africa and USA.
- In Dubai, he got Letters of Credit (L/Cs) opened by various companies A1, A2 & A3, which were controlled by him, for Importers I1, I2 & I3 in Dubai.
- Exporters E1, E2 & E3 in India, as well as in other parts of the world, were the beneficiary parties for these L/Cs.
- For opening of L/Cs, “A” used his networking with Issuing Banks (B1, B2 & B3), who tied up with the Advising Banks (B4, B5 & B6). Advising Banks were responsible for transmission of funds into accounts of Exporters E1, E2 & E3.
- L/Cs were opened for amounts substantially higher than the real value of the actual consignments being traded.
- “A” arranged for trade documents to be prepared so as to make such documents acceptable to the Issuing Banks B1, B2 & B3 and Beneficiary/Advising Banks B4, B5 & B6.
- “A” in turn remitted the inflated value of exports to Exporters E1, E2 & E3 in India, as per the terms of L/Cs, after adding the drug money lying with him. Funds remitted to India were as per the terms of the L/C.
- After receiving the higher remittances, the Exporters E1, E2 & E3 retained the actual price of the goods exported and transferred the additional amount to the family members (R1, R2 & R3) of “A” in India and to his associates in other parts of the world.
- In a slight variation of this technique of misuse of L/Cs, “A” facilitated opening of L/Cs for importers (I1, I2 & I3), for commission. The L/Cs were opened at inflated values. He collected fair value of imports from the importers but remitted the inflated L/C amount of higher value to the Exporters E1, E2 & E3. The additional funds thus transferred were collected from Exporters, by associates of “A”
- Thus, by misuse of Letters of Credit, funds were moved across countries, in the guise of trade finance, after intermingling of drug money of criminal origin.



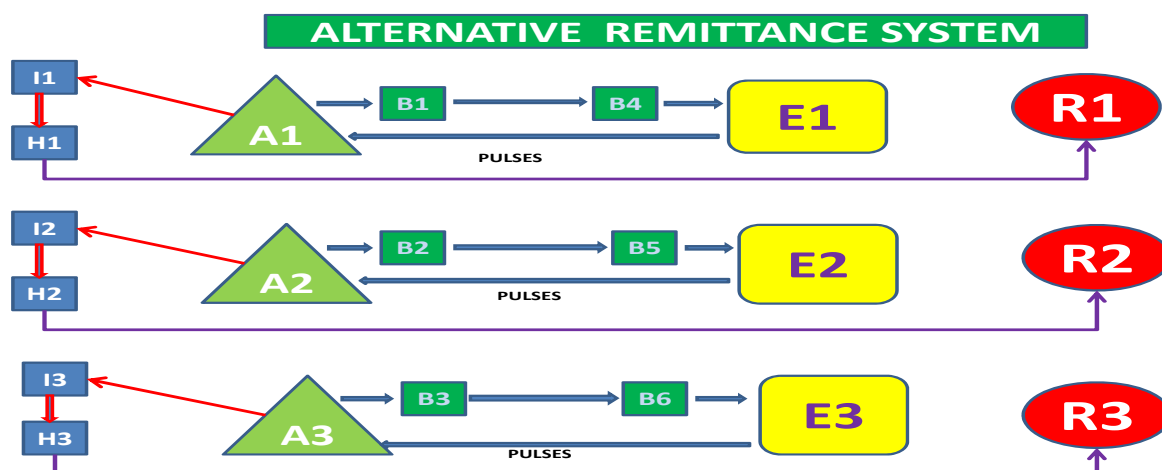
## MISUSE OF L/C



### ***B. USE OF ALTERNATIVE REMITTANCE SYSTEM***

- “A” also utilised the services of alternative remitters (hawala operators) to move funds offshore.
- The legal framework in Dubai allows hawala to operate after registration with the UAE Central Bank.
- One way of use of Alternate Remitters by “A” was by funding those individuals who were visiting Dubai and were in need of funds in local currency, which he provided.
- The flush of money arising from the narcotics trade was enough to cater to large demands of individuals as well as of companies.
- On return to their home jurisdiction, these individuals made compensatory payments to the assigned agents of “A” located in their home jurisdiction, in currency of their home jurisdiction, thereby completing the clandestine movement of funds from Dubai to the home jurisdiction of these individuals.
- In another technique of use of Alternate Remitters, “A” facilitated trade in prohibited / restricted goods by falsifying trade documents by using his network of associates in India. Fake documents were prepared to fraudulently export pulses from India, when such exports were banned.
- To circumvent the restriction, the goods were mis-described in trade documents, which also enabled mis-declaration of value and thereby also enabled movement of excess funds to the exporting jurisdiction.
- He used alternative remitters (Hawala operators) H1, H2 & H3 to settle differential payments arising out of such trade in prohibited / restricted goods.
- Through the companies A1, A2 & A3 controlled by him, “A” first imported pulses into Dubai and made payments of contractual price to Exporters E1, E2 & E3, through banking channels / through L/C.
- Through his companies A1, A2 & A3, he resold the imported pulses at higher prices to the real importers I1, I2 & I3, who were in fact the genuine buyers of pulses in Dubai and elsewhere.

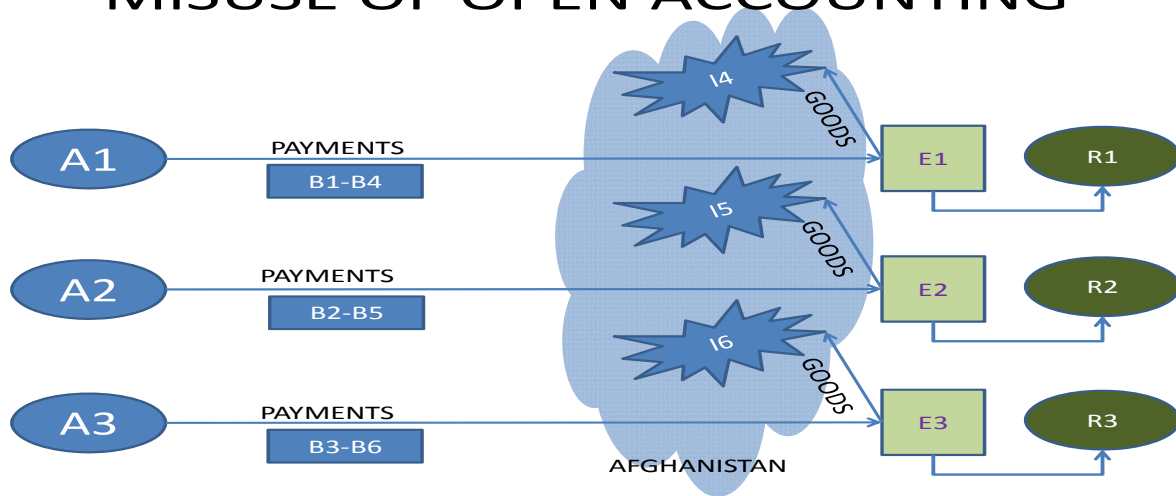
- Since A had pre-dated the contracts to allow for export of pulses from India after ban, he earned huge profits on resale in foreign market facing shortage of pulses.
- Profits earned on resale of pulses were also remitted to his agents R1, R2 & R3 through Alternate Remitters (Hawala operators) H1, H2 & H3.



### C. USE OF OPEN ACCOUNT

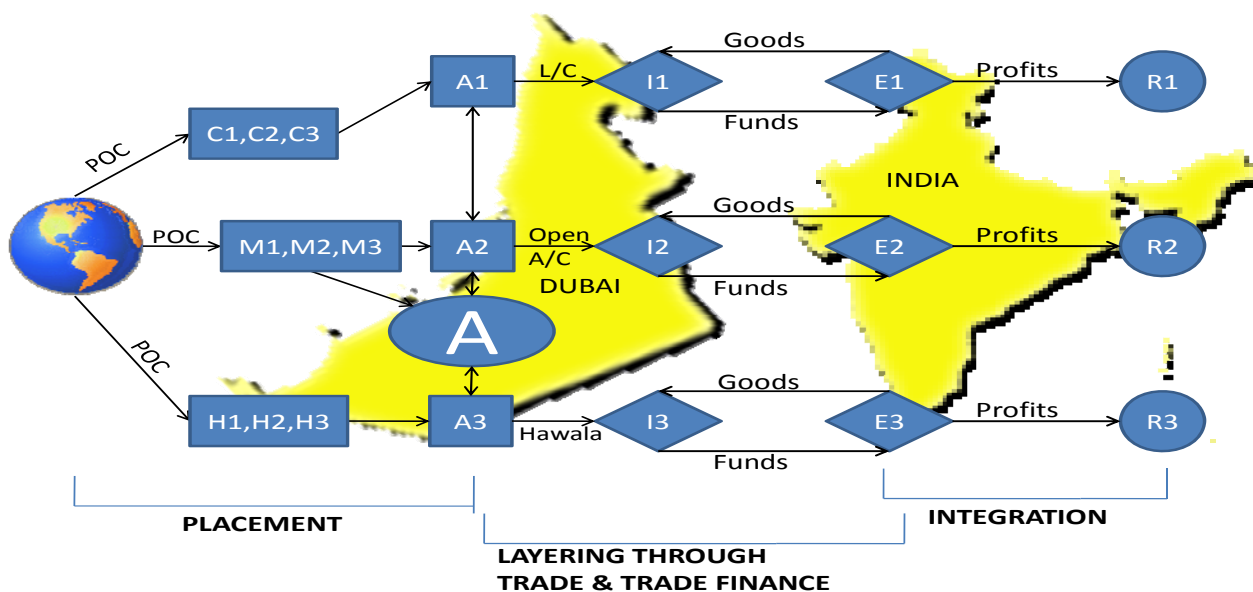
- “A” organised exports of artificial jewellery from India to various importers (I4, I5 & I6) in Afghanistan.
- Companies A1, A2 & A3 established in Dubai by “A” were declared as ‘Notifying Parties’ in trade documents for exports from India to Afghanistan.
- Payment was sent by A1, A2 & A3 through banks B1, B2 & B3 in Dubai to the accounts of Indian exporters E1, E2 & E3 in banks B4, B5 & B6 in India.
- The Indian exporters having received payments through open accounting paid the commission in cash for such exports to the agents of “A” in India, viz. R1, R2 & R3.
- Thus, in exchange for drugs originating from Afghanistan, “A” arranged for delivery of goods in that jurisdiction, by indulging in countertrade through trade manipulation.
- “A” used his companies A1, A2 & A3, by declaring them as ‘Notifying Parties’ in the trade documents to facilitate misuse of the trade finance mechanism of open account trading.

## MISUSE OF OPEN ACCOUNTING



215. As stated at the outset, “A” was operating a very complex scheme of TBML, which can be summed up as follows:

- “A” indulged in laundering of proceeds from Narcotics trafficking and was based in Dubai. He opened a number of associate companies (A1, A2 & A3) to place money into the financial system by using the services of Cash Couriers (C1, C2, & C3) or Money Service Bureaus (M1, M2 & M3) or Alternative Remitters or Hawala Agents (H1, H2 & H3).
- To remit part of the proceeds of crime to his home in India, he tied up with Indian exporters (E1, E2 & E3).
- The Indian exporters (E1, E2 & E3) overvalued the exports to earn export incentives. The individual “A” used letters of credit, open accounting as well as alternative remittance system for movement of money between importers (I1, I2 & I3) and the Indian exporters E1, E2 & E3.
- The actual importers / users situated in the same jurisdiction as “A”, collected the goods exported from India and paid to “A”, the actual cost (true value) of the goods so imported.
- “A” in turn remitted the inflated proceeds of exports either against the L/Cs opened in the names of Importers (I1, I2 & I3) OR through open account OR through alternative remittance system to Indian Exporters (E1, E2 & E3).
- After receiving the higher remittances, the Exporters (E1, E2 & E3) retained the actual costs and conveyed the additional amounts to the associates (R1, R2 & R3) of “A” in India or elsewhere.
- The Exporters (E1, E2 & E3) gained from excess export incentives on overvalued exports and from being able to export banned goods and to inaccessible destination. The importers gained by acquiring goods which were not available through normal trade channel.
- “A” succeeded to launder criminal proceeds through trade finance.



### Commentary:

216. In this complex case study, the funds originated from narcotic drug sales and fraudulent export incentives. The proceeds of crime were laundered by mis-declaration of description of goods and forgery of documents.
217. In the first illustration, the misuse of Letter of Credit mechanism of trade finance to disguise the movement of criminal funds in conjunction with overvaluation of goods, where both exporter as well as importers were in league, has been depicted.
218. In the second illustration, use of alternative remittance system (Hawala) has been explained, wherein funds were moved in connection with trade in prohibited / restricted goods. Using the international trade system, the criminal organisation was able to transfer illegal funds by using trade transactions to justify payment through the financial system.
219. In the third illustration, criminals have mis-used the open account trade finance system to launder the crime money. Movements of funds were disguised by using the third party remittance system. Mis-declaration of goods, over-valuation of goods and barter of goods were deployed, coupled with misuse of trade finance mechanisms of L/Cs and open account trading. Extensive use of Alternate Remitters was also resorted to move funds illegally across countries, at will.

### Red Flags

1. Trade in banned/prohibited/restricted goods.
2. Overvaluation of export goods.

3. Exports to sensitive destinations of a new commodity by a regular exporter of some other commodity.
4. Introduction of notifying parties in trade documents without adequate explanation.
5. Export Remittances received from third parties.
6. Settlement of accounts for trade between two countries through a third jurisdiction.
7. Movement of abnormally large sums of money in various accounts of the individuals and companies which are not related to the nature of their business.

#### **ALTERNATIVE REMITTANCE SYSTEMs:**

220. Some of the case studies have referred to Alternate Remittance System. Therefore a brief write-up on Alternative Remittance System by Bangladesh in the box placed below explain the basic features of such a system whereby accounts are settled across the nations through compensatory payments made in local currency of trading partners for differentials arising between true value of goods involved in trade and formal means of trade finance.

#### **ALTERNATIVE REMITTANCE SYSTEM**

Alternative Remittance System i.e. “Hundi” or “Hawala” is a way to transfer funds through informal channels. Hundi means “trust” and hawala means “transfer related to money”. These are also often referred to as “underground banking system” or “parallel banking system” or “informal money transfer system”. Alternative remittance systems are financial services, traditionally operating outside the conventional financial sector, where value or funds are moved from one geographic location to another. (FATF Best Practice Paper 2006: Combating the abuse of Alternative Remittance System <http://www.fatf-afi.org/media/fatf/documents/recommendations>.)

Under-invoicing / over invoicing of goods and services are used in TBML to move funds across the borders not only to disguise its illicit origin but also to evade taxes and duties as well as get undue export incentives. To settle such over or under payments in international trade transactions, Hundi or Hawala mechanisms are used.

Hawala Operators (Hawaldars) or Hundi Dealers operate their business under a global network which helps them to do their business worldwide. Generally Hawala Operators or Hundi Dealers have other formal businesses, like exchange houses, travel agencies, import/export or shipping companies, grocery stores, gold and jewellery shops, textile or apparel shops and many other business establishments. Often these operators arrange fund transfers for a large number of migrant workers and immigrants, who send back their savings to the home jurisdiction. The popularity of their business lies in 3 C’s viz. certainty, convenience and cheap. The transactions ensure that remittance reaches the beneficiary at an assigned address in definite time period, for a charge which is less than the transfer charges of formal system. Moreover the accounts among the Alternative Remittance System operators are settled by making compensatory payments in local currency to persons in the home jurisdiction who have been assigned by the partner hawala operator located abroad.

Since such hawala transactions remain largely unreported, there is no reliable data available on the magnitude of hawala / hundi / other alternative remittance systems. The significance of this trade finance mechanism as means to fill up the gap arising out of difference in actual trade value being exchanged and the amount transferred through formal mechanisms call-for larger awareness and focused training on the subject of Alternative Remittance System.

## CONCLUSIONS

221. The first case study relating to ‘merchanting trade’ reveals how a third party located in a third jurisdiction ostensibly to facilitate trade between two other countries introduces TBML vulnerability in such trade transactions. The financing of different segments of trade through diverse mechanisms of trade finance can introduce risks in the trade transactions which are difficult to assess by financial institutions.
222. The second case study brings-out how the ‘carousel trade’ with the circulation of the same goods across the countries, call for close scrutiny of such transactions, for TBML. The mechanisms of financing trade through factoring and through disbursement of trade credit to overseas suppliers are fraught with risks for financial institutions unless due diligence is exercised about the overseas trading partner.
223. The third case study reveals how proceeds of crime can move to a jurisdiction where the AML regime may have weaknesses. It also shows the vulnerability arising from trade finance mechanisms in a system wherein the integrity of financial institutions has been undermined by weak application of fit and proper controls. The operations of ‘exchange houses’ owned and controlled by criminals coupled with ‘compromised’ working of a bank make trade finance mechanisms means for indulging in TBML.
224. The fourth case study demonstrates how proceeds of crime generated out of a ‘ponzi scheme’ were moved abroad through a variant of alternative remittance system viz. hawala. The TBML allowed for integration of proceeds as legal remittance.
225. The fifth case study reveals how the creation of veneer of international trade can help conceal the identity of true beneficiary from the financial institutions. The use of a corporate structure of shell companies located in sensitive jurisdictions of a tax haven can hoodwink the institutions of trade finance.
226. The sixth case study demonstrates yet another variant of alternative remittance system viz. Black Market Peso Exchange. The use of international trade acts as a lubricant to facilitate the cycle of laundering of narcotic drugs funds.
227. The seventh case study shows multiple forms of international trade and various mechanisms of trade finance which give inherent flexibility to criminals to adopt those forms and types which suit the demands of a situation. Such adaptability of these forms makes the detection and prevention of TBML a very challenging task.
228. The FATF Paper 2006 highlighted four basic techniques of TBML. These basic techniques relate to abuse of trade transactions and combine with techniques which abuse trade finance mechanisms for TBML to occur. Four of the trade finance techniques which can be inferred from the analysis in this Paper are following:
  - a) **Cash Inflow Based Payment:** Cash is structured into formal financial system through smurfing and other processes so as to make payments for international trade transactions. Trade finance payments are funded out of cash receipts of the financial institutions.

Normally cash will be received in one jurisdiction and payment through trade finance mechanisms will be made in the jurisdiction of trading partner. Thus the veneer of international trade is used to obliterate the signs of illicit origin of the payments.

- b) **Third Party Payment:** A third party is introduced preferably in a third jurisdiction, in the payment channel between two trading partners. Such third party may be a notifying party between consignor and consignee. It can also be a facilitator who acts as an intermediary for trade transaction as well as for trade finance mechanism. In still other situations such third party may either be a factoring or forfaiting entity. The technique involves making the process of due diligence to be conducted by domestic financial institutions more difficult to succeed.
  - c) **Segmental Modes of Payment:** Instead of opting to finance single trade transaction as a whole, the trade transaction is split into parts so that each part is financed through different modes of trade finance. The segmental modes of trade finance are used to fund the trade transaction. This technique is normally used wherein a third party is brought in between the exporter and the importer. For imports of goods, letters of credit mechanisms may be used and on the re-export of such goods to other jurisdictions wire transfers may be opted. The technique introduces different levels of risks for different segments of trade so that financial institutions are unable to make correct risk assessment of the trade finance payments.
  - d) **Alternative Remittance Payment:** Trade transactions which are vulnerable to TBML involve transfer of goods of which the true value does not correspond to the amount of payment transferred through formal mechanisms of trade finance. To finance such gap the alternative remittance mechanisms are utilized. The technique involves 'squaring-off' the 'differential gaps' by making compensatory payments in local currency to domestic persons assigned by the trading partner located abroad.
229. The techniques of trade finance abuse succeed only when they work in conjunction with the techniques of abuse of trade transaction. The segregation of sectors of finance and of trade prevents investigators from having an integrated approach. Isolated sectoral outlooks fail to raise 'alerts' about the TBML.

## **CHAPTER V - CONCLUSIONS**

### **CHALLENGES**

#### ***Growing Concerns***

230. This study on TBML, done six years after the landmark FATF Study of 2006, has reaffirmed the conclusion of the earlier study that TBML is an important channel for criminal organizations and terrorist financiers to move money or value to disguise its illicit origin and to integrate it into the formal economy. The rapid growth in the global economy has made international trade an increasingly attractive avenue to move funds through goods and services. There are instances brought out in this Paper where the veil of international trade was deliberately created so as to launder the proceeds of crime. A number of publications on TBML during the intervening period of six years, as reviewed in Chapter-I, reflect the growing concern about its potential as a form of ML.
231. While various jurisdictions may have different levels of preparedness for identifying and investigating TBML, the general recognition of its existence and of its future potential underscore its significance. In fact, international trade remains a viable option for movement of value even in those jurisdictions that do not have a well-developed financial or banking sector. Thus, TBML is a concern for the international community even though it may presently impinge upon various jurisdictions without the same impact.

#### ***Complex Phenomenon***

232. TBML is a complex phenomenon since its constituent elements cut across not only sectoral boundaries but also national borders. The dynamic environment of international trade imparts inherent flexibility for TBML to take multiple forms. To discern TBML from among the legitimate activities of international trade has become a daunting task. The features of the dynamic environment that also distinguish TBML from other forms of ML were identified in Chapter I. Such features include occurrence of TBML through intermingling of the trade sector with the trade finance sector in cross-border transactions. The foreign exchange market and the long supply chain make international trade more vulnerable to TBML.
233. To assist in recognizing the multiple forms of TBML, Chapter II of this Paper has enumerated specific characteristics of TBML. These attributes of TBML have been categorized into those relating to trade finance and to trade. For further simplification trade characteristics have been classified into four groups, namely: jurisdictions; goods; corporate structures; and, predicate offences. This methodology has allowed the Project Team to identify some 'Red Flags' which relate to specific characteristic of TBML.

#### ***Statistics and Data***

234. Very few cases of trade base ML were reported. Thus statistics on detection of TBML and on TBML related STRs were also very limited. One of the major obstacles in devising future strategy to tackle TBML has been the lack of reliable statistics relating to it. Most jurisdictions do not distinguish TBML from other forms of ML. Hence they have reported that they do not maintain separate statistics for TBML. Moreover, the data on trade which



is largely collected by the Customs Department in most of the jurisdictions are oriented to serve purposes other than those of TBML. While the trade data is collected, maintained and analysed by the Customs they neither have a legal mandate to undertake TBML investigations nor do they have training and competence to utilize such data to combat TBML. Merely 25% of the jurisdictions have reported that TBML investigations were initiated on the basis of trade data.

235. As already pointed out in this Paper any strategy that focuses only on the trade sector leaving-out the corresponding elements of the trade finance sector would be inadequate to tackle TBML. Having a warehouse of trade finance data within financial institutions without correlating such data to that of the trade sector will not allow effective targeting of TBML. The Project Team holds that an isolated sectoral approach has not worked. An integrated holistic strategy to fight TBML is needed.

### ***Sharing of Information***

236. It is evident from the feedback from most of the jurisdictions that sharing of the information obtained domestically and internationally, has impediments. These impediments relate to inadequate and delayed response, restrictions on the use of the information furnished and insistence on confidentiality or secrecy clause which hamstring its evidential value. More than 50% of the jurisdictions reported having initiated TBML investigations on referrals from other agencies. Again, more than 50% of the jurisdictions reported seeking information from foreign jurisdictions. Laying platforms for effective and prompt sharing of information domestically and internationally can go a long way to combat TBML.

### ***Trade Finance Vulnerabilities***

237. Investigators in many jurisdictions face major challenges comprehending trade finance products and the implications of the use of trade finance in TBML. Chapter-III of this Paper attempts to be a ready reckoner for investigators to assist them to better understand trade finance products. This should assist investigators to begin to incorporate trade finance analysis in their investigations.
238. The trade finance products set out in Chapter III reveal a menu of choices that are available to genuine traders to facilitate trade. While the various trade finance products reduce trade transaction costs, their accessibility have also made them vulnerable to abuse.
239. Information relating to the trade finance products remain concentrated within the financial sector. Often the financial institutions are not aware of the significance of the information held by them to TBML investigators. A TBML investigator would need to obtain crucial data from financial institutions and correlate that with the information available in the trade sector so as to sieve 'TBML-laced' transactions from the predominantly genuine trade flows, the 'noise'.
240. Chapter II of this Paper finds that jurisdictions were unanimous in highlighting a need for training to be provided to regulators regarding TBML vulnerabilities and risks associated with trade finance activities.

### ***TBML Techniques of Trade Finance***

241. The selection of Case Studies in Chapter IV has the intention of expounding the ‘modus operandi’ involved in TBML not only to throw light on the abuses in the trade sector but also to bring home the contributory anomalies of the trade finance sector. Several of these Case Studies reflect the confidence of the criminal syndicates in the impregnability of the veneer of the international trade they have created to move illicit funds and indulge-in TBML. The syndicates have not merely taken advantage of existing trade structures but have gone on to create new and additional structures for TBML.
242. A number of ‘Red Flags’ have been enumerated from each of the 7 Case Studies. The ‘Red Flags’ relate to trade as well as to trade finance. These red flags also corroborate the patterns identified for TBML in Chapter-II.
243. On the basis of the analysis of patterns, modus operandi and red flags, four techniques of TBML relating to trade finance have been formulated. The four techniques are: cash inflow payments; third party payments: segmental modes of payment; and, alternative remittance payments. These four techniques are those which have been more commonly used by criminal syndicates to support the practice of abusing the trade sector.

### **THE WAY FORWARD**

244. Any strategy to prevent and combat TBML needs to be based on dismantling TBML structures, while allowing genuine trade to occur unfettered. A holistic approach, with emphasis on inter-agency coordination and international cooperation, needs to be universally adopted by the policy-makers. A comprehensive strategy which takes into account sectoral peculiarities, agency specialization and jurisdictional frameworks can only address the challenges in tackling TBML. Some of the steps that can form part of the way forward are discussed ad seriatim.

### ***Standardization of Data and Statistics***

245. Presently, statistics relating to TBML are not distinguished from those of other forms of ML. Data needed to combat TBML remain dispersed over various domestic sectors. Practices to compile and collate the statistics and data relevant to TBML vary among jurisdictions. There is a need to have common formatting of how TBML statistics are to be recorded and maintained so that trends are more easily identifiable.
246. If centralization of data and statistics is not presently possible then access of competent authorities to such statistics and data should be ensured. Cross-referencing data relating to trade and trade finance can be the starting point for adopting a risk based approach. Such an approach will not only lead to prioritization of limited resources but will also facilitate genuine trade without compromising the necessary governance over TBML. A risk based approach will help capture crucial trade data along with providing an ability to keep track of its corresponding payments data. To ensure efficient real time delivery of analysis the adopting of an electronic platform may be essential.

247. Monitoring foreign exchange may be an option for some jurisdiction in identifying anomalies to detect TBML. one of the finding of the project team is there exists an acute need to correlate trade data with the foreign exchange data of a jurisdiction so as to detect TBML and in particular identify cases wherein value is moved across countries in the form of goods without corresponding outgo of foreign exchange as its payment.
248. As an example, the development of a foreign exchange monitoring system by South Korea endeavours to cross-reference trade related data based on an electronic platform. By working out trends and past performances the system conducts some risk analysis to select risk-prone foreign exchange transactions for more specific scrutiny. There is a capacity to systematically target TBML.
249. Capturing data on trade and trade finance in standard format across the jurisdictions will ease cross-referencing for discovering trade anomalies leading to detection of TBML. Correlating such findings with systematic compilation of foreign exchange data can foster efficient strategies to prevent and combat TBML.

#### ***Domestic Task Forces***

250. Multiple agencies are associated either directly or indirectly in fighting TBML. One way-forward to combine the respective competencies of relevant authorities for combating TBML is to form domestic task-forces. Task-forces focused on TBML investigations will need to have the ability to utilize the expertise of each agency without comprising its functional skills. It is suggested that to be successful the task-force must set its modes of communication and interaction. The operating platform should be electronic which allows for virtual exchange and management of large quantities of information. If a manual operating platform is adopted then task-force members must ensure regular interaction. The coordination achieved through a TBML task-force should go some way in providing effective support in intelligence, investigation and prosecution work relating to TBML.
251. Customs agencies hold trade data in most of the jurisdictions surveyed. Traditionally such data is used to detect and investigate Customs offences relating to smuggling and duty evasion. The regulators in the trade finance sector issue alerts on the basis of the data available within the sector for the use of financial institutions.
252. Law enforcement agencies responsible for investigating ML use the same tools to investigate TBML without any specialized training to undertake such investigations. These agencies work in isolation without the necessary inputs from Customs and Regulators. FIUs in most jurisdictions analyse and disseminate suspicious transaction reports on the information furnished by the financial sector without corresponding inflow from trade sector and foreign exchange control agencies (in those jurisdictions with such controls). Tax authorities exclusively focus on investigation relating to tax evasion. Transfer pricing audits conducted by such authorities do not identify implications for TBML.
253. The competent authorities tasked with tackling TBML are more often than not focused on work mandated by the legislation as it relates to them. They may have even achieved professional specialization and competence in such mandated work. However, the strategy

to prevent and combat TBML requires expertise created through the combination of all such authorities. It is recognized however that any necessary amendment in the given legal framework may not be easy and in some cases may impact on the respective professional efficiency that exists.

### ***International Cooperation***

254. International cooperation to combat TBML is difficult to achieve. The formal and informal means of international cooperation used include treaties and agreements. The Mutual Legal Assistance Treaty (MLAT) and the Customs Mutual Assistance Agreement (CMAA) are bilateral arrangements for exchange of information and are often deployed for combating TBML. However, exchanges made through formal channels often result in delayed responses, inadequate information and limited or no further feedback.
255. Informal channels include interaction with the representatives of foreign jurisdictions assigned for the purpose in the domestic jurisdiction. Informal channels which exist as part of bilateral diplomatic arrangements can also be used to tackle TBML.
256. The Project Team believes that there is an urgent need to strengthen the existing bilateral arrangements and to build multilateral mechanisms for international cooperation. The bilateral arrangements must ensure prompt exchange of information with regular follow-ups which should result in more efficient delivery. The multilateral mechanisms may entail equal commitment of all trading jurisdictions for coordination in matters relating to TBML. Technological innovations for effective communication across jurisdictions can provide permanency to multilateral arrangements. In this regard an initiative by the World Customs Organisation (WCO) to develop the concept of Globally Networked Customs (GNC) for exchange of information may turn-out to have significant strategic value.

### ***TBML Focused Training***

257. TBML focused training is an absolute necessity for the anti-TBML strategy to succeed. Customs, ML investigating LEA, FIU, Tax Authorities and Regulators have all identified a pressing need for more focused training so that their personnel can have an adequate knowledge base to detect, prevent and combat TBML. Many of the jurisdictions have reported limitations with regard to resources which they can spare to provide training capable of mitigating TBML activities. This study reiterates the findings of the FATF Best Practices Paper 2008 to incorporate a TBML focus in the existing AML training programmes.
258. The sharper focus on TBML in existing training programs can be brought about by incorporating specific topics which relate to TBML. The case studies, the red flags and typology papers on TBML may be disseminated during such programs. As trade essentially involves multiple jurisdictions, there is a need for Law Enforcement Officers to understand the legal and procedural aspects of other jurisdictions. Training should be aimed at making use of trade data analysis as well as cross referencing trade data with trade finance data and understanding any useful tools developed to identify trade anomalies which may lead to investigation and prosecution of TBML cases. Inter-linkages of tax frauds and customs violations with TBML also need to be explained.

259. The significance of domestic coordination and of international cooperation to tackle TBML must be conveyed during training programs. Further, as a large number of private players are involved in international trade they need to be apprised of concealed TBML threats in any outreach programs that are conducted. Thus, capacity building among all competent authorities and private industry is an important component of any successful strategy to prevent and combat TBML.

### ***Further Research***

260. The ongoing fight against TBML through the comprehensive strategy discussed in this Chapter should spur further research so as to meet emergent challenges. The possible areas of such research may be briefly delineated as follows:

- a) **Services:** Treatment with regard to TBML vulnerabilities in trade of services shall require specialized tools. Services more than goods, give wide scope for manipulation in pricing, quantification and delivery time-schedule. It may therefore be imperative to undertake further research to develop case-studies and identify red-flags.
- b) **Terrorist Financing:** Moving of funds through trade to fund illicit activity of terrorism in an important issue confronting the global security. Further research to look into aspects of such illicit fund movement through trade is called for.
- c) **Financing the proliferation of WMD:** Building on work undertaken by the FATF, there is a need to further consider vulnerabilities of trade finance to the financing of the proliferation of WMD.
- d) **Risk Based Approaches:** Adoption of risk based approaches in the strategy to combat TBML is essential not only to maximise resources but to target TBML without inhibiting genuine trade flows. Research should be undertaken to work-out models which could be practically adopted by various jurisdictions.
- e) **Tax evasion:** The work done by international bodies such as OECD, Global Financial Integrity, have brought into focus trade-mispricing and transfer pricing as well as their correlation with poverty. With continued enhanced focus on tax evasion, or use of tax havens and on evasion of customs duty, it is essential to do research to explore their inter-linkages with TBML.

261. A comprehensive strategy to meet the growing concern about TBML has been recommended in this Chapter. Challenges in formulating such a strategy have been identified. Ways forward for addressing some of these challenges have been suggested. International trade needs to be kept free of TBML so that the full benefit from effective and efficient global trade can be realised by the community of nations.

## **ANNEX A - TBML RED FLAGS FROM CURRENT & EXISTING STUDIES**

262. The Red Flags which have been mentioned in the existing studies have been categorized as per the scheme adopted in Chapter II of this Paper. Annex A sets out red flags gleaned from existing studies, as well as those identified in the current study. In many cases there is a correlation between previous studies and the present study.
263. The Red Flags set out in this section of Annex A are derived from studies by the FATF, US (FINCEN & ICE), Australia (AIC) the Wolfsberg Group and studies by BRANNIGAN (2010) and Brown (2009).

### **Red Flags relating to Trade Finance:**

- The transaction involves receipt of cash (or other payments like wire transfers, checks, bank drafts or postal money orders) from unrelated third party entities or an intermediary (either an individual or an entity) apparently unrelated to the seller or purchaser of goods. This may be done to obscure the true origin of the funds (e.g. Wires where no apparent business relationship appears to exist between the originator and the beneficiary) ;
- The transaction involves the use of repeatedly amended or frequently extended letters of credit without reasonable justification or for reasons like changes of the beneficiary or location of payment ;
- A customer's inability to produce appropriate documentation (e.g. invoice or any other document) to support a requested financial transaction or bank finds double invoicing or a Customer fails to provide adequate information about the originator, beneficiary, and purpose of the wire transfer;
- The method of payment appears inconsistent with the risk characteristics of the transaction; (For example, the use of an advance payment for a shipment from a new supplier in a high-risk country or Frequent transactions involving rounding or whole dollar amounts).
- Phantom shipping – no goods are shipped and all documentation is completely falsified to move funds in the guise of trade
- Negotiable instruments (such as traveller's checks, cashier's checks and money orders) in round denominations under \$3,000 used to fund domestic accounts or, alternatively, smuggled from a jurisdiction for placement into accounts at foreign financial institutions. The negotiable instruments may be sequentially numbered or purchased at multiple locations and may frequently lack payee information or contain visible broker markings or symbols. These negotiable instruments may also be used to pay for goods and services.

- International wire transfers received as payment for goods into bank accounts or processed through correspondent or intermediary accounts in a particular country, especially where the ordering party (importer of goods) of the wire does not live in the country from which the wire originated. (e.g. Wires originating from jurisdictions which have been highlighted in relation to black market peso exchange activities),
- Sudden onset and equally sudden cessation of payments – typically wire transfers – within a short duration. This could be an indication that the account is temporarily being used to launder illicit proceeds.
- A foreign based importing entity with accounts in exporting country receiving payments from locations outside the areas of their customer base.
- Unusual deposits occurring in combination with one or more of the following indicators:
  - Multiple deposits occurring in various locations when the account owner resides elsewhere, for example, deposits made in various cities when the account owner resides in a different city.
  - Multiple bank accounts held by a customer individually or along with closely related family members. These accounts may be held at one or more financial institutions. Such accounts may be used to facilitate the placement and layering of illicit funds.
  - Checking accounts receiving cash deposits in amounts under \$1,000 as frequently as several times per month. These deposits may be followed by ATM withdrawals in foreign countries. This method, sometimes referred to as micro-structuring, is used by “smurfs” to deposit cash which may then be used to purchase goods.
- Foreign visitors opening multiple bank accounts at one or more financial institutions. Individuals may travel to a foreign jurisdiction with instructions to establish multiple bank accounts as a straw party. Upon return to their home country the straw account owner signs all of the blank checks and relinquishes control of the checkbooks and ATM cards tied to the accounts to the beneficial owner who now has control of the accounts. The following are examples of activity common to these accounts:
  - Cash deposits received using over-the-counter deposit slips since the checkbooks containing the pre-printed deposit slips as well as ATM cards are located out of that country;
  - Deposits which are frequently made in multiple cities / jurisdictions;
  - Withdrawals made via foreign ATM transactions; or
  - Withdrawals via check transactions that exhibit a difference between the handwriting for the signature and the payee portions of the check.
- Unusual activity in established bank accounts for non-resident aliens, such as structured cash and monetary instrument deposits; checks written from the domestic account to foreign businesses with no apparent relationship to the account holder; and international wire transfers to entities that do not appear to have any relationship with the originator.

- Sequentially numbered checks drawn on domestic bank accounts negotiated through foreign money services businesses.

264. It is important to remember that no one activity by itself is a clear indication of trade-based ML. Due to some similarities with legitimate financial activities, financial institutions should evaluate indicators of potential trade-based ML in combination with other red flags and expected transaction activity for its customer before making determinations of suspiciousness. Additional investigation and analysis may be necessary to determine if the activity is suspicious, based on information available to the financial institution.

#### **Red Flags relating to Jurisdictions:**

- The commodity is shipped to (or from) a jurisdiction designated as “high risk” for ML activities;
- The commodity is transhipped through one or more jurisdictions for no apparent economic reason;
- Customers conducting business in high-risk jurisdictions. Although not specifically identified by the authority handling AML work or FATF ; FTZs may be added to the list of high-risk jurisdictions given that there is an argument that FTZs exacerbate the risk
- Customers shipping items through high-risk jurisdictions, including transit through non-cooperative countries
- Unusual shipping routes or trans-shipment points
- Funds transferred into a country’s domestic accounts that are subsequently transferred out of the account in the same or nearly the same amounts. Origination and destination locations are frequently high risk jurisdictions.

#### **Red Flags relating to Goods:**

- Significant discrepancies between the descriptions of the goods on the transport document (i.e., bill of lading), the invoice, or other documents (i.e., certificate of origin, packing list, etc.).
- Significant discrepancies appear between the description of the goods on the bill of lading (or invoice) and the actual goods shipped;
- Significant discrepancies appear between the value of the commodity reported on the invoice and the commodity’s fair market value;
- The size of the shipment appears inconsistent with the scale of the exporter or importer’s regular business activities;
- The type of commodity being shipped is designated as “high risk” for ML activities; [e.g. high-value, low-volume goods (e.g. consumer electronics, diamonds), which have high turnover rates and which present valuation difficulties].
- Shipment locations or description of goods that are inconsistent with the letter of credit



- Documentation showing a higher or lower value or cost of merchandise than that which was declared to Customs or paid by the importer (i.e. commodity over-valuation or under-valuation )
- Customers involved in potentially high-risk activities, including those subject to export/import restrictions such as equipment for military or police organisations of foreign governments, weapons, ammunition, chemical mixtures, classified defence articles, sensitive technical data, nuclear materials, precious gems, or certain natural resources such as metals, ore and crude oil
- Obvious misrepresentation of quantity or type of goods imported or exported
- A shipment that does not make economic sense (e.g. the use of a forty-foot container to transport a small amount of relatively low value merchandise)
- The type of commodity being traded appears inconsistent with the exporter or importer's usual business activities (e.g. a steel company that starts dealing in paper products, or an information technology company that suddenly starts dealing in bulk pharmaceuticals)
- Carousel transactions: the repeated importation and exportation of the same high-value commodity
- Packaging inconsistent with commodity or shipping method

**Red Flags relating to Corporate Structures used:**

- A transaction involves the use of front (or shell) companies.
- Companies or Money Exchange Bureaus located in third countries used as intermediaries for transfer of goods or money.
- A transaction structure that appears unnecessarily complex through introduction of corporate entities so that it obscures the true nature of the transaction.
- Companies operating out of foreign countries, especially when it is difficult or impossible to determine ownership or controlling persons of the company, or when the business purpose is not fully apparent.

## RED FLAGS CONFIRMED IN THE APG TBML PAPER

265. The present paper has categorized the Red Flags received from various jurisdictions in response to the questionnaire into following five broad categories.

### TRADE FINANCE

266. Based on the responses received from jurisdictions, red flags relating to financial & banking products may be categorized as follows:

- a) Use of **letters of credit** to move money between those countries, where such trade would not normally occur and / or is **not consistent with the customer's usual business activity**. A Letter of credit is generally resorted to so as to accord more legitimacy to the transaction in order to conceal the real facts.
- b) The **method of payment** requested by the client appears **inconsistent with the risk characteristics of the transaction**. For example receipt of an advance payment for a shipment from a new seller in a high-risk jurisdiction.
- c) The transaction involves the receipt of cash (or by other payment methods) **from third party entities** that have no apparent connection with the transaction or which involve front or shell companies or wire instructions / payment from parties which were not identified in the original letter of credit or other documentation. The transactions that involve payments for goods through cheques, bank drafts, or money orders not drawn on the account of the entity that purchased the items also need further verification.
- d) The transaction involves the use of repeatedly **amended or frequently extended letters of credit** without reasonable justification or that includes changes in regard to the beneficiary or location of payment without any apparent reason.
- e) **Unusual deposits** i.e. use of cash or negotiable instruments (such as traveller's cheques, cashier's cheques and money orders) in **round denominations** (to keep below reporting threshold limit) to fund bank accounts and to pay for goods and services. The negotiable instruments may be sequentially numbered or purchased at multiple locations and may frequently lack payee information. Further, cash payments for high-value orders are also indication of TBML activity.
- f) Inward remittances in **multiple accounts** and payments made from multiple accounts for trade transaction of same business entity are indicators for TBML. In this regard the study of foreign exchange remittances may help detect the offence.
- g) In the case of **merchanted trade**, the trade finance mechanism should be in place for both export leg as well as import leg of transaction. If the Trade Finance mechanism, for example, Letters of Credit, have been provided for only the import leg of the transaction and not for export leg, it also indicates the possibility of TBML.

## JURISDICTIONS (ORIGIN OR DESTINATION OF GOODS)

- a) The commodity is shipped to or from a jurisdiction designated as '**high risk**' for ML activities or sensitive / non co-operative jurisdictions.
- b) The commodity is **transhipped** through one or more such high risk / sensitive jurisdictions for no apparent economic reason.
- c) Presence of **Free Trade Zones / Special Economic Zones** also affects the sensitiveness of a jurisdiction as far as TBML is concerned. FTZs are also emerging as being especially vulnerable to TBML. FATF (2010: 4) defines FTZs as 'designated areas within countries that offer a free trade environment with a minimum level of regulation'. In the said report, FATF noted that most zone authorities operate separate company formation services from those that exist in the rest of the jurisdiction and market the ease of setting up a legal entity in an FTZ to attract business. Many zone authorities request little or no ownership information of the companies interested in setting up in the zone. As a result, it is simpler for legal entities to set up the firms/companies in FTZs and hide the name(s) of the true beneficial owners. This lack of transparency has allowed companies located in FTZs to create layers of transactions that are difficult (if not impossible) for law enforcement agencies to follow (FATF 2010). It also reported that 'goods introduced in a FTZ' are generally not subject to the usual customs controls, with goods undergoing 'various economic operations, such as transshipment, assembly, manufacturing, processing, warehousing'. FinCEN has identified TBML red flags that are specific to FTZs. In its 2010 report, FinCEN (2010: 4) signalled that a number of red flags seen in conjunction with shipments of high dollar merchandise (such as electronics, auto parts and precious metals and gems) to duty free trade zones could be an indication of a trade-based ML activity.

These include:

- i. third-party payments for goods or services made by an intermediary (either an individual or an entity) apparently unrelated to the seller or purchaser of goods. This may be done to obscure the true origin of the funds;
  - ii. amended letters of credit without reasonable justification;
  - iii. a customer's inability to produce appropriate documentation (ie invoices) to support a requested transaction; and
  - iv. significant discrepancies between the descriptions of the goods on the transport document (ie bill of lading), the invoice, or other documents (ie certificate of origin, packing list etc) (FinCEN 2010).
- d) **Circuitous route of shipment** and/or **circuitous route of financial transaction** or **Order for the goods** is placed by firms or individuals from foreign countries other than the jurisdiction of the stated end-user.
  - e) Transaction involves **shipment of goods inconsistent with normal geographic trade patterns** of the jurisdiction i.e. trade in goods other than goods which are normally exported/ imported by a jurisdiction or which does not make any economic sense e.g.

Semi-conductor manufacturing equipment being shipped to a jurisdiction that has no electronics industry.

## NATURE OF GOODS

- a) Where significant discrepancies appear between the **description, quality and quantity** of the goods on the documents such as bills of lading, invoices etc and the actual goods shipped. The misrepresentation may also be in relation to or type / grade of goods. For example, a relatively inexpensive good is supplied but it is invoiced as being more expensive, of different quality or even as an entirely different item so the documentation does not accurately record what is actually supplied. This technique is particularly useful in TBML. Cheap cloth items / waste thereof are declared as premium quality garments to launder the criminal money.
- b) Significant discrepancies appear between the **value** of the commodity reported on the invoice and the commodity's fair market value. This is done either in conjunction with mis-declaration of the description / quality / grade of goods or without it. This is also often associated with mis-declaration of the jurisdiction of origin.
- c) **Consignment size or type of commodity** being shipped appears **inconsistent with the scale or capacity of the exporter or importer's having regard to their regular business activities** or the shipment does not make economic sense i.e. there is no reasonable explanation for the client's financial investment into the shipment.

## COPRPORATE STRUCTURES

- a) The transaction involves the use of **front or shell companies**. Both shell and front companies can be used to facilitate TBML but in different ways. A shell company has no real operating activity and is used to hide ML activity and the identities of individuals involved so as to obscure the money trail. If activity is traced to the company it is literally an empty shell. As FATF (2010: 20) explained TBML and other ML schemes rely on the ability of the perpetrator of the crime to distance themselves from the illicit proceeds. Shell companies enable illicit actors to create a network of legal entities around the world. By contrast, a front company has real business whose legitimate operations are used as a cover for ML and other criminal activity. In many ways, front companies present a much more significant TBML threat than shell companies. The characteristics of offshore companies, for example, convenient formation, free operation, tax exemption and financial secrecy, all provide rather good veneer to disguise ML
- b) Numerous **sole proprietorship businesses/private limited companies** set up by seemingly unrelated people (proxies) are found to be controlled by the same group of people. For the setting up of such businesses false addresses are registered.
- c) Trade transaction reveals links between representatives of companies exchanging goods i.e. same owners or management. TBML requires collusion between traders at both ends of the import/export chain. **Related party transactions** (ie transactions between entities

that are part of the same corporate or business group) can possibly make TBML easier and more difficult to detect. Related party transactions, including transfer pricing, rely on mutual agreements between the parties, rather than free market forces. As the FATF (2006: 5) pointed out, over- or under-invoicing of goods and services requires collusion between the exporter and importer. Although there is a higher risk of related party transactions being used for fraud and for TBML, dealings between related parties are not necessarily illegal. d) Transfer pricing is a related party transaction that is commonly used by transnational corporation as part of their financial and tax planning strategy. Multinational organisations use transfer pricing to shift taxable income from jurisdictions with relatively high tax rates to jurisdictions with relatively low tax rates to minimise income tax. Similar strategies are also employed in relation to import duties and value added tax. FATF (2006: 3) made it clear though that in the case of transfer pricing, the reference to over- and under-invoicing relates to the legitimate allocation of income between related parties, rather than customs fraud.

## **PREDICATE OFFENCES OF TBML**

267. 15% of the jurisdictions have reported that **tax evasion** is the predominant predicate offence in TBML cases whereas 10% of the jurisdictions have reported **customs offences** as the main predicate offence. Other responses indicate that predicate offenses are often related to commercial fraud, IPR, Narcotics, human trafficking, terrorist financing, embezzlement, corruption, organized crime (racketeering), dealing in banned goods, conducting illegal business, speculation etc. One Reporting jurisdiction indicated that ML is considered to be an autonomous offence and there is no need to prove the existence or nature of the predicate offence in order to prosecute hence as a consequence, there is no systemic link between ML cases and other crimes.

## **ANNEX B - SUMMARY OF RESPONSES TO THE APG TBML QUESTIONNAIRE**

268. 19 jurisdictions responded to the questionnaire: Anguilla, Australia, Belgium, Belize, Bhutan, Cambodia, Canada, Fiji, Hong Kong, China, India, Japan, Macao, Malaysia, Myanmar, Nepal, OCO, Pakistan, Singapore, Vietnam and USA. Oceania Customs Organisation also responded to the questionnaire.

### **SUMMARY OF RESPONSES**

#### **SECTION A. COORDINATING AGENCIES**

	<b>Yes</b>	<b>No</b>
<b>1A. Reason for very few cases of TBML reported up to 2011:</b>		
i. It is not an issue;	<b>4</b>	<b>1</b>
ii. It is a policy/law, issue that results in no detection; or	<b>8</b>	
iii. Other Issues (Training, awareness / other) that results in no detection;	<b>9</b>	
No Report / Not Applicable etc: <b>(1)</b>		
<b>2A. Did the FATF 2006 &amp; 2008 papers describe all types of TBML?</b>	<b>11</b>	<b>4</b>
No Report / Not Applicable etc: <b>(5)</b>		
<b>3A. Whether any Government department records information on goods imported and exported into your jurisdiction?</b>	<b>19</b>	<b>-</b>
No Report / Not Applicable etc: <b>(1)</b>		
<b>4A. Does this agency, if Customs, has dedicated financial investigators with experience in trade related offences and or ML investigations?</b>	<b>5</b>	<b>10</b>
Does this agency, if other than Customs, has dedicated financial investigators with experience in trade related offences and or ML investigations?		<b>5</b>
No Report / Not Applicable etc: <b>(2)</b>		
<b>6A. Does your jurisdiction use any database to identify the value of goods, ie under/overpricing?</b>	<b>12</b>	<b>5</b>
No Report / Not Applicable etc: <b>(3)</b>		
<b>7A. If your jurisdiction has identified cases of TBML?</b>	<b>9</b>	<b>8</b>
No Report / Not Applicable etc: <b>(3)</b>		
<b>8A. Has your jurisdiction undertaken any of the following:</b>	<b>2</b>	<b>14</b>
<b>a. A typologies study on TBML, or Abuse of the Trade Finance sector in the jurisdiction?</b>		
<b>b. A risk assessment of TBML or Abuse of Trade Finance sector in the jurisdiction?</b>	<b>2</b>	<b>14</b>
<b>c. A risk assessment on Transfer Pricing.</b>	<b>2</b>	<b>14</b>
<b>d. A risk assessment of the use of Alternative Remittance Sectors in trade finance.</b>	<b>2</b>	<b>14</b>
No Report / Not Applicable etc: <b>(4)</b>		

## SECTION B. CUSTOMS AGENCIES

	Yes	No
<b>1B.</b> Does Customs conduct investigations into TBML or Transfer pricing?	<b>8</b>	<b>11</b>
If so, does the Customs agency also conduct the ML aspect of this investigation?	<b>4</b>	<b>4</b>
No Report / Not Applicable etc: <b>(1)</b>		

### **2B.** Statistics on the number of TBML investigations in the past 5 years.

Details	2007	2008	2009	2010	2011
Nos of TBML investigations initiated / identified / referred	-	-	5	8	219
Amount involved in such offences	-	-	-	-	Not available
Result of investigations	-	-	-	-	-
Value of assets attached / frozen	-	-	-	\$90 million#	Not available
Value of assets confiscated	-	-	-	-	-

Not Available/ Not Maintained separately / Nil: **(17)**

*# US reported TBML investigations completed in 2010 resulted in approx US\$90 million in seizures.*

	Yes	No
<b>3B.</b> Is Customs part of any joint financial investigation/ML task force that conducts investigations into these offences?	<b>9</b>	<b>9</b>
No Report / Not Maintained separately: <b>(2)</b>		
<b>4B.</b> Has Customs received training on TBML?	<b>8</b>	<b>10</b>
Does Customs provide training to other agencies on TBML issues?	<b>2</b>	<b>10</b>
No Report / Not Applicable etc: <b>(2)</b>		
	Yes	No
<b>5B.</b> Whether any impediments encountered when conducting investigations? Eg impediments regarding the release of FIU data to the agency or agency unable to share trade information etc.	<b>6</b>	<b>6</b>
No Report / Not Applicable etc: <b>(8)</b>		
	Yes	No
<b>6B.</b> Whether information is collected on type of goods, value of goods, importer, exporter, owner, receiver, shipping company etc?	<b>17</b>	
No Report / Not Applicable etc: <b>(3)</b>		
<b>7B.</b> Do you conduct analysis of trade information that could be used to identify, investigate or prosecute TBML?	<b>10</b>	<b>9</b>
No Report / Not Applicable etc: <b>(1)</b>		
<b>8B.</b> Has your jurisdiction identified patterns of goods that are involved in TBML?	<b>5</b>	<b>13</b>
No Report / Not Applicable etc: <b>(2)</b>		
<b>9B.</b> Are goods in TBML usually trans-shipped?	<b>1</b>	<b>5</b>
And is there any pattern of jurisdiction of origin (ie where are the goods usually shipped from, or are there some jurisdictions more prevalent than others as a point of origin)?	<b>2</b>	<b>2</b>
No Report / Not Applicable etc: <b>(14)</b>		
<b>10B.</b> How are the investigations into TBML usually initiated? ie information from intelligence, law enforcement, FIU data, STRs, trade data etc.		
On the basis of inter-agency intelligence	<b>8</b>	
On the basis of intra-agency intelligence	<b>8</b>	

information from intelligence	information from law enforcement,	information from FIU data	information from STRs,	information from trade data	information from other sources
<b>6</b>	<b>9</b>	<b>7</b>	<b>6</b>	<b>5</b>	<b>3</b>
No Report / Not Applicable etc: <b>(9)</b>					

	<b>Yes</b>	<b>No</b>
<b>11B.</b> During your investigations do you seek information from your international counterparts?	<b>11</b>	<b>3</b>
During your investigations do you seek information from your WCO?	<b>10</b>	<b>3</b>
No Report / Not Applicable etc: <b>(6)</b>		
<b>12B.</b> During your investigations do you seek information from Domestic LEAs?	<b>10</b>	<b>3</b>
No Report / Not Applicable etc: <b>(7)</b>		
<b>13B.</b> During your investigations do you seek information from international LEAs ?	<b>8</b>	<b>4</b>
During your investigations do you seek information from FIUs?	<b>8</b>	<b>3</b>
No Report / Not Applicable etc: <b>(8)</b>		
<b>14B.</b> Is there any impediments to the receipt or dissemination of this information?	<b>8</b>	<b>5</b>
Is there any legal requirements for the dissemination of information related to trade (ie MoU)?	<b>4</b>	<b>4</b>
No Report / Not Applicable etc: <b>(7)</b>		
<b>15B.</b> Does your agency maintain an intelligence database on import and export of goods?	<b>15</b>	<b>4</b>
Do you cross reference this information with other government databases, i.e. companies registry, tax records, criminal records etc.?	<b>6</b>	<b>7</b>
No Report / Not Applicable etc: <b>(1)</b>		
<b>16B.</b> Whether any indicators and red flags of TBML identified?	<b>7</b>	<b>5</b>
No Report / Not Applicable etc: <b>(8)</b>		
<b>17B.</b> Have you shared any TBML related intelligence with your foreign counterparts?	<b>6</b>	<b>10</b>
If so are you aware of the results of that dissemination, i.e. aid in investigation, result in prosecution etc.	<b>3</b>	
No Report / Not Applicable etc: <b>(4)</b>		
<b>18B.</b> Are there any challenges and obstacles for your agency to identify or investigate TBML?	<b>8</b>	<b>3</b>
No Report / Not Applicable etc: <b>(9)</b>		

## **SECTION C. LAW ENFORCEMENT AGENCY MANDATED TO INVESTIGATE ML (MAY INCLUDE CUSTOMS / INVESTIGATIVE FIUS)**

### **1C. Statistics on the number of TBML investigations in the past 5 years**

<b>Details</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>
No. of TBML investigations initiated / identified / referred from other agencies	1	18	27	20	<b>223</b>
Amount involved	USD 2.17 Million	USD 6.16 Million	USD 420.59 Million	USD 46.88 Million	USD 81.52Million



Result of investigations	-	-	Prosecution pending	Prosecution pending	Prosecution pending
Value of assets attached / frozen ( US \$)	USD 2.17 Million	USD 6.16 Million	USD 44.98 Million	USD 91.04 Million #	Under investigation
Value of assets confiscated	-	-	-	-	-
No Report / Not Applicable etc/ Nil : (15)					
#: In addition to above as per report of USA: 208 investigations. TBML investigations completed during 2010 resulted in approximately \$90 million dollars in seizures.					

	Yes	No
<b>2C.</b> Does the law enforcement agency conduct investigations into TBML or Transfer pricing?	11	4
If so does the law enforcement agency also conduct the ML aspect of this investigation?	<b>11</b>	<b>3</b>
No Report / Not Applicable etc: (5)		
<b>3C.</b> Is the law enforcement agency part of a joint financial investigation/ML task force that conducts investigations into these offences?	<b>9</b>	<b>6</b>
No Report / Not Applicable etc: (5)		
<b>4C.</b> Has the law enforcement agency received training on TBML?	<b>7</b>	<b>10</b>
Does it provide training to other agencies on TBML issues?	<b>3</b>	<b>9</b>
No Report / Not Applicable etc: (3)		
<b>5C.</b> Are there any impediments encountered when conducting investigations?	<b>6</b>	<b>9</b>
No Report / Not Applicable etc: (5)		
<b>6C.</b> How are TBML investigations initiated? i.e. referrals from other agencies etc.?		
1. From Internal intelligence: (7)		
2. Referrals from other agencies: (11)		
No Report / Not Applicable etc: (7)		
<b>7C.</b> Of the TBML matters investigated what is the average size, in dollar terms, of the offence?	USD 557.3 Million in 19 cases.	
No Report / Not Applicable etc: (15)		
<b>8C.</b> What are the predicate offences that have in the past been associated with TBML?		
1. Narcotics		
2. Domestic Crime / Organised Crime		
3. Corruption		
4. Customs Violations		
5. Tax Evasion		
6. Manufacturing, stockpiling, transporting and/or trading in banned goods		
7. Conducting business illegally		
8. Speculation		
9. Commercial fraud		
10. IPR		
11. Human Trafficking & Terrorist Financing		
12. Embezzlement		
13. Fraud		
No Report / Not Applicable etc: (12)		
<b>9C.</b> What types of goods are involved in TBML matters?		
1. Metal scrap.		

<ol style="list-style-type: none"> <li>2. Textile materials.</li> <li>3. Zero duty goods like Diamonds. (2)</li> <li>4. Precious metals.</li> <li>5. Luxury watches</li> <li>6. Good where the taxes are high or which are heavily controlled</li> <li>7. Electronic goods</li> <li>8. Illicit tobacco products</li> <li>9. Counterfeit Products</li> <li>10. Bulk Commodities.</li> </ol>		
No Report / Not Applicable etc: (14)		
<b>10C.</b> What types of corporate structures are used by criminal syndicates in TBML investigations? <ol style="list-style-type: none"> <li>1. Companies: (6)</li> <li>2. Offshore Companies: (5)</li> <li>3. Others: joint-venture companies registered in developing countries (1)</li> <li>4. Criminals don't use Corporate Structure. (1)</li> </ol>		
	<b>Yes</b>	<b>No</b>
Where such offshore companies are registered?	<b>3</b>	
Is there any pattern to jurisdictions that they are registered?		
No Report / Not Applicable etc: (16)		
	<b>Yes</b>	<b>No</b>
<b>11C &amp; 12C.</b> Whether you receive information from the Customs agency?	<b>12</b>	<b>1</b>
Are there any restrictions on the use of this information?	<b>7</b>	<b>5</b>
No Report / Not Applicable etc: (7)		
<b>14C.</b> Does your agency have specialist financial investigators who conduct the TBML investigations?	<b>9</b>	<b>7</b>
No Report / Not Applicable etc: (4)		

	<b>Value in USD</b>	
<b>15C.</b> What was the value of any assets forfeited as a result of the investigation?	USD 72.66 Million	
No Report / Not Applicable etc: (17)		
<b>16C.</b> What red flags or indicators of the TBML activity have you identified?		
No Report / Not Applicable etc: (12)		
	<b>Yes</b>	<b>No</b>
<b>17C.</b> Have investigations of Alternative Remitters identified instances of TBML?	<b>3</b>	<b>7</b>
Have investigations of Alternative Remitters identified instances of abuse of trade finance?	<b>2</b>	<b>7</b>
No Report / Not Applicable etc: (10)		

## SECTION D. FIU

### 1D. Statistics on the number of TBML STRs in the past 5 years

Details	2007	2008	2009	2010	2011
Nos of TBML STRs received	15	49	186	690	1054
Nos of TBML STRs disseminated	7	28	130	474	699
Value of STRs received (USD)	\$756	\$15462	\$164614	\$486256	\$7315
No Report / Not Applicable etc: (15)					
		<b>Yes</b>		<b>No</b>	
<b>2D.</b> Is the FIU part of a joint financial investigation/ML task force that conducts		<b>3</b>		<b>15</b>	

investigations into these offences?		
No Report / Not Applicable etc: (2)		
<b>3D.</b> Has the FIU received training on TBML?	<b>7</b>	<b>11</b>
Does it provide training to other agencies on TBML issues?	<b>7</b>	<b>11</b>
No Report / Not Applicable etc: (2)		
<b>4D.</b> Are there any impediments encountered when conducting intelligence gathering? For example, impediments regarding the release of FIU information, unable to receive law enforcement information, lack of access to databases etc.	<b>5</b>	<b>11</b>
No Report / Not Applicable etc: (4)		
<b>5D.</b> Can Customs agencies receive financial information from the FIU?	<b>18</b>	<b>-</b>
No Report / Not Applicable etc: (2)		
<b>6D.</b> Have requests been made for sharing financial intelligence (FIU to FIU, FIU to LEA etc)?	<b>14</b>	<b>4</b>
No Report / Not Applicable etc: (2)		

## SECTION E. TAX AUTHORITIES

	<b>Yes</b>	<b>No</b>
<b>1E.</b> Do you have any estimates of the size of (detected and undetected) TBML and transfer pricing in your jurisdiction?	<b>2</b>	<b>9</b>
If yes, what is the size? USD 19 Million (1 Jurisdiction)		
No Report / Not Applicable etc: (9)		
<b>2E.</b> Does the Tax Authority conduct investigations/audits into TBML or Transfer Pricing?	<b>3</b>	<b>10</b>
No Report / Not Applicable etc: (7)		

### **3E.** Statistics on the number of TBML/transfer pricing detections in the past 5 years

Details	2007	2008	2009	2010	2011
No of TBML/transfer pricing investigations initiated / identified		1	1	3	63
Amount involved in such offences (USD)		USD 234.6	USD 111.8	USD 49.3	USD 240.9
Result of investigations		<i>Not prosecuted</i>	Not prosecuted	Not prosecuted	Not prosecuted
Assets attached / frozen/confiscated					

Nil /No Report / Statistics not maintained for TBML cases /Not Applicable etc: (18)		
	<b>Yes</b>	<b>No</b>
<b>4E.</b> Is the Tax Authority part of a joint financial investigations/ML/Task Force that combats TBML?	<b>5</b>	<b>6</b>
If so, is there a lead agency?	<b>2</b>	<b>3</b>
No Report / Not Applicable etc: (9)		
<b>5E.</b> Has the Tax Authority received training on TBML?	<b>4</b>	<b>9</b>
Does it provide training to other agencies on TBML issues?	<b>1</b>	<b>10</b>
No Report / Not Applicable etc: (6)		
<b>7E.</b> Does the Tax Authority receive FIU data for the purpose of investigation of administrative issues?	<b>6</b>	<b>5</b>
No Report / Not Applicable etc: (9)		

## SECTION F. AML REGULATOR

	<b>Yes</b>	<b>No</b>
<b>1F.</b> Has the regulator or supervisor provided guidance to reporting entities regarding TBML vulnerabilities and red flags?	<b>11</b>	<b>5</b>
No Report / Not Applicable etc: (4)		
<b>2F.</b> Does the regulator or supervisor provide training to reporting entities and their own staff on TBML?	<b>8</b>	<b>8</b>
Does the regulator have experts in the area of Trade Finance?	<b>5</b>	<b>7</b>
No Report / Not Applicable etc: (4)		
<b>3F.</b> Does AML supervision include trade finance aspects of compliance?	<b>10</b>	<b>6</b>
No Report / Not Applicable etc: (4)		
<b>4F.</b> Does your jurisdiction have foreign currency controls?	<b>11</b>	<b>4</b>
No Report / Not Applicable etc: (5)		
<b>5F.</b> Do foreign currency controls have a role in identifying abuse of trade finance or TBML?	<b>5</b>	<b>4</b>
No Report / Not Applicable etc: (11)		
<b>6F.</b> Have investigations of Alternative Remitters identified instances of TBML or abuse of trade finance?	<b>3</b>	<b>9</b>
No Report / Not Applicable etc: (8)		

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