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TRADE-BASED MONEY LAUNDERING

October 2023 | Theme 382

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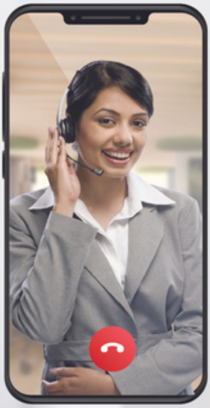

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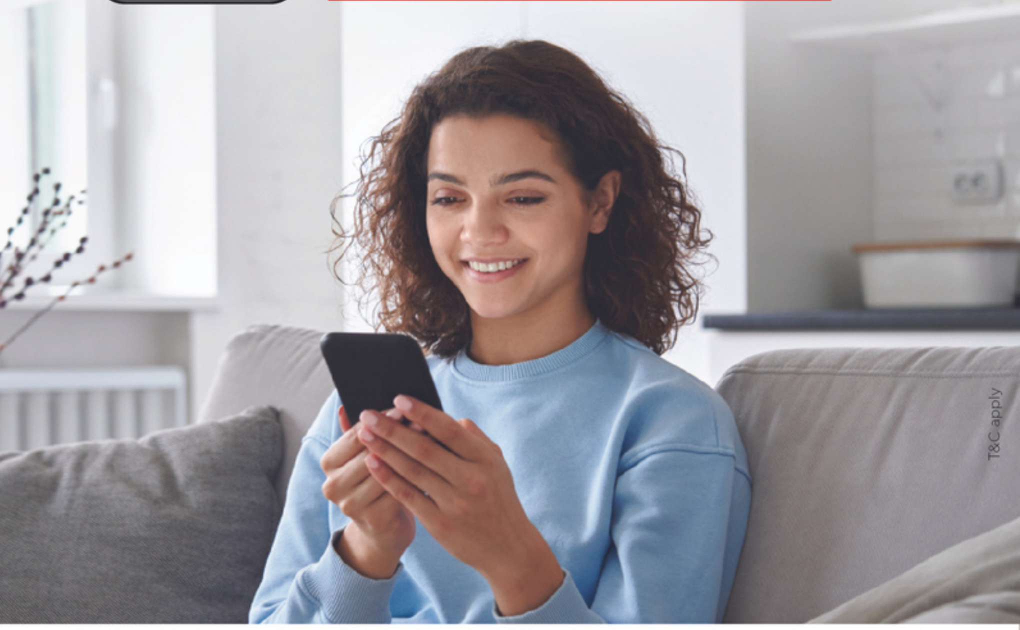

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Trade-Based Money Laundering

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"Money laundering is giving oxygen to organised crime."

Enrique Peña Nieto, President of Mexico, June 2012

The 'SIB Students' Economic Forum' is designed to kindle interest in the minds of the younger generation. We highlight one theme in every monthly publication. Topics of discussion for this month is 'Trade-Based Money Laundering'.

Trade-Based Money Laundering (TBML) is a sophisticated method employed by criminals and illicit entities to launder money, obscure the origins of illicit funds, and finance illegal activities. In this comprehensive article, we will delve deep into the world of TBML, exploring its mechanisms, real-world examples, regulatory efforts to combat it, and its broader implications on global financial systems.

Introduction:

Money laundering is a sophisticated process that criminals use to make illegally obtained assets, often referred to as "dirty money," appear legitimate by obscuring their origins. This nefarious activity is driven by the need to legitimize funds acquired through unlawful means, such as drug trafficking, corruption, tax evasion, fraud, or organized crime. Money laundering is not a single action but rather a multi-step operation that involves a series of intricate transactions designed to conceal the illegal source of the funds.

Three Stages of Money Laundering

Placement:

The first stage of money laundering is known as "placement." During this phase, the launderer's primary objective is to introduce the illicitly gained funds into the legitimate financial system without arousing suspicion. This is often considered the riskiest stage of money laundering.

Criminals employ various tactics, such as depositing large sums of cash in small amounts to avoid reporting thresholds, buying valuable assets like art or real estate, or utilizing intermediaries known as "money mules" to transport funds across borders.The aim is to blur the connection between the illegal source of the money and the legitimate financial system.

Layering:

The second stage, "layering," involves creating intricate layers of financial transactions to create confusion and complicate the audit trail. Money launderers employ a wide range of techniques during this phase. They may transfer funds between numerous bank accounts, convert currencies multiple times, engage in a series of transactions, and employ offshore entities to further obscure the true source of the funds. The purpose of layering is to make it exceptionally challenging for investigators to trace the laundered money back to its illegal origins. The more complex and convoluted the trail, the more effective the layering process.

Integration:

The final stage of money laundering is "integration." Here, the laundered funds are reintroduced into the legitimate economy in a manner that makes them appear entirely lawful. At this point, the money has been cleansed of its illicit origins and can be used or reinvested without raising suspicion. Money launderers may invest in legitimate businesses, purchase assets like real estate, or enter the financial markets. Once integrated, the money is effectively "laundered" and has successfully entered the legitimate financial system. Detecting and recovering such funds becomes exceedingly difficult, as they now blend seamlessly with legitimate assets.

Understanding these three stages of money laundering is crucial for law enforcement agencies, financial institutions, and policymakers.

Trade-Based Money Laundering

Trade-Based Money Laundering (TBML) is a specialized form of money laundering that primarily revolves around trade transactions. Unlike other forms of money laundering that involve complex financial transactions, TBML exploits the global trade system to legitimize illicit funds. Essentially, TBML involves manipulating international trade to make illegal proceeds appear legal. Criminals take advantage of the inherent complexity of cross-border trade to obscure the origins of their ill-gotten gains.

Key Elements of TBML

Trade Transactions:
At the heart of TBML lies the exploitation of legitimate international trade transactions. Criminals engage in the movement of illicit funds by embedding them within the vast flow of international commerce. This can involve the buying and selling of goods and services across borders, creating an ideal cover for money laundering.

Complex Supply Chains:
TBML often thrives within intricate supply chains. Criminals insert themselves into these complex networks, leveraging multiple intermediaries, subsidiaries, and business entities. This web of transactions makes it challenging for authorities to discern the illicit financial flows among the legitimate trade activities.

Mispricing:
One of the hallmark techniques of TBML is mispricing. This involves manipulating the prices of goods and services in trade documents such as invoices, bills of lading, and purchase orders.

Over-invoicing and Under-invoicing:
Over-invoicing and under-invoicing are techniques where criminals manipulate the prices of goods or services in trade documents. Over-invoicing involves inflating the prices, making it seem like the transaction is more valuable than it actually is. Conversely, under-invoicing understates the prices, making it appear as if the goods were sold for less. These price discrepancies help criminals move money across borders, either overpaying or underpaying for goods to legitimize their illicit funds.

Phantom Shipping and Fictitious Invoices:
Phantom shipping and fictitious invoices involve creating fake records of trade transactions. Criminals might fabricate shipping documents and invoices for goods that never existed or were never actually shipped. These fake transactions serve as a means to justify fund transfers and create a false paper trail, making it challenging for authorities to detect the illicit flow of funds.

Smurfing:
Smurfing, also known as structuring, involves breaking down large transactions into smaller ones to avoid arousing suspicion and bypass reporting requirements. Instead of moving a large sum of money at once, criminals make numerous smaller transfers that, individually, appear innocuous but collectively add up to significant sums. Smurfing helps money launderers circumvent anti-money laundering monitoring systems.

Shell Companies:
Criminals establish shell companies, which are entities with no genuine business operations or assets. These companies exist primarily on paper and are used to facilitate fraudulent trade transactions.

Circular Trading:
Circular trading involves the movement of goods in a circular pattern among different entities, often within the same criminal network. The same merchandise is bought and sold repeatedly between these entities, creating a complex web of transactions. This convoluted trading cycle is designed to confuse investigators and make it challenging to identify the illicit financial flows hidden within the circular trade. These methods and techniques collectively illustrate the complexity and sophistication of TBML, where criminals exploit trade transactions to launder money, ultimately legitimizing funds obtained through illegal means.

Detecting and combating TBML requires advanced monitoring systems, international cooperation, and vigilance within the global trade ecosystem.

Regulatory Framework & Efforts

FATF Guidelines

The Financial Action Task Force (FATF) plays a central role in establishing international standards and guidelines to combat money laundering, including TBML:

International Standards: FATF has developed a series of recommendations known as the "FATF 40 Recommendations" that set the global standards for anti-money laundering (AML) and Combating Financing of Terrorism (CFT) efforts. These recommendations provide guidance on identifying and mitigating TBML risks.

Specific Guidance: FATF has issued specific guidance on how countries should address TBML. This guidance helps governments and financial institutions understand the unique challenges posed by TBML and provides best practices for detection and prevention.

Mutual Evaluations: FATF conducts mutual evaluations of member countries' AML/CFT regimes to assess their compliance with the recommendations. These evaluations include an examination of how well countries are addressing TBML risks. Non-compliance can lead to reputational damage and sanctions.

Public Statements: FATF issues public statements identifying jurisdictions with strategic deficiencies in their AML/CFT regimes. This naming-and-shaming approach encourages countries to strengthen their measures against TBML.

Role of Financial Institutions

Financial institutions, including banks, play a critical role in the fight against TBML:

Due Diligence: Financial institutions are required to conduct enhanced due diligence to identify and report suspicious trade transactions that may be indicative of TBML. They must know their customers (KYC) and understand the nature of their trade activities.

Transaction Monitoring: Banks employ sophisticated transaction monitoring systems to detect unusual or high-risk trade transactions. These systems use algorithms and pattern recognition to flag potentially suspicious activities.

Suspicious Transaction Reporting: Financial institutions are obligated to report suspicious transactions to relevant authorities, such as financial intelligence units or regulatory bodies. Reporting is a key component of AML efforts and helps trigger investigations into potential TBML activities.

Staff Training: Banks invest in staff training to ensure employees can recognize signs of TBML and are aware of their reporting obligations. This includes understanding red flags associated with trade transactions.

Government Initiatives

Governments worldwide have launched various initiatives to combat TBML:

Legislation and Regulation: Governments enact and update laws and regulations to address TBML risks. This includes specific provisions related to trade transactions, reporting requirements, and penalties for non-compliance.

Coordination: Government agencies collaborate with each other and with international counterparts to share information and intelligence on TBML activities. Interagency cooperation is crucial for effective enforcement.

Conducting a TBML Risk Assessment:

How often should a bank carry out a TBML Risk Assessment?

Typically, banks conduct these assessments annually or more often if the risk profile changes. For example, entering a new country, serving a new sector, and adding a new banking product can change the risk profile. The results of risk assessment can aid management in making risk based business and control decisions. Any observed deficiencies should be tracked and monitored until remediated.

Financial Intelligence Units (FIUs): Many countries have established FIUs responsible for receiving, analysing, and disseminating financial intelligence to combat money laundering and TBML. These units serve as hubs for collecting and sharing information.

International Cooperation: Governments engage in international efforts to combat TBML, including sharing best practices, coordinating investigations, and extraditing individuals involved in TBML schemes across borders.

Technology Adoption: Governments invest in advanced technologies, including data analytics and artificial intelligence, to enhance their ability to detect TBML activities.

Public Awareness: Some governments run public awareness campaigns to educate businesses and individuals about the risks associated with TBML and the importance of reporting suspicious transactions.

In conclusion, the regulatory framework, and efforts to combat TBML involve international standards set by FATF, the crucial role of financial institutions in due diligence and reporting, and government initiatives encompassing legislation, coordination, technology, and public awareness.

Combating TBML requires a comprehensive and collaborative approach involving multiple stakeholders at both national and international levels.

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