An emerging money laundering threat facing compliance officers in 2008

By Kenneth Rijock, Financial Crime Consultant for World-Check

Compliance officers at financial institutions are required to, in addition to staying current on the relevant laws and regulations, keeping up with the dynamic and ever-changing world of money laundering trade-craft. Whilst their busy workdays often leave them precious little time to review new industry publications and recent court decisions, they must ensure that they, and their staff, are constantly updating their knowledge of emerging money laundering threats.

As a former practicing money launderer who spent a decade in the dark world where schemes are created that are designed to defy identification and interdiction by bank compliance officers, I know that new tactics often escape scrutiny for the sole reason that the compliance officer is unfamiliar with them. They are often ignored, and passed by unsuspecting compliance staff, who mistakenly assume that they are ordinary, and legitimate, international business transactions.

Today, we shall examine one of the most important types of money laundering schemes that the compliance officer at bank with international commerce must be familiar with, which could successfully transit his or her bank, raising the potential risk of regulatory penalty or reputation damage, should they be discovered, and investigated by law enforcement, at a later date.

The subject to be covered is Trade-based Money Laundering, whereby international financial criminals move large sums through wire transfers and letters of credit using methods often unknown to even bankers experienced in trade financing. Whilst the exact amount of this type of illicit commerce is unknown, it is believed to be the technique responsible for the largest amount of undiscovered money laundering transfers in global financial commerce.

This is not Transfer Pricing, where the profits are taken in a jurisdiction where there are little or no tax consequences, this denying the onshore taxing jurisdiction its lawful share, but a more malevolent creation.

The character and depth of the problem was discovered quite by accident by two academics from Florida International University fifteen years ago. A computer science professor and a business professor entered all current existing US Department of Commerce international trade statistics into a computer programme, in the hopes of uncovering international trade patterns, but what they learnt surprised them.

A small percentage of the international transactions were sold for amounts totally inconsistent with their market value; some items which were of minimal value were being sold for huge sums, and vice versa, when compared with the norms displayed in the vast majority of trade sales. There were no business explanations for these glaring inconsistencies in the pricing.

The professors correctly concluded that money launderers were ingeniously hiding proceeds of criminal funds transfers within the vast world of international trade, taking full advantage of the fact that bank officers do not have the technical background to determine, on a real-time basis, whether

the stated prices of many manufactured goods, especially high-tech items, constituted the true market prices. Simply stated, bankers are not cross-trained as engineers, and therefore do not have the training and experience to vet wholesale pricing of technical goods.

A company will set up two captive businesses; one in the country where the illicit funds are earned, and the other in the designated recipient location, or nearby. The receiving location, often organized as a manufacturing company, will purport to make and invoice very expensive products, which will be paid by the front company at the sending location. In truth and in fact, the goods shipped are of nominal value, but the stated prices, cleverly invoiced at as large sums of money, are billed and paid. Thus, millions of dollars is sent via wire transfers, but the bankers supervising the transactions are deceived by the facially correct shipping documents.

In another variation upon this theme, expensive goods are actually manufactured and shipped, but billed out and paid at nominal rates. This allows a large amount of assets representing wealth to be sent in international trade, and sold for cash later on the global market, in a third-world location, far away from European Union and North American law enforcement and regulatory agencies.

Other clever permutations of trade-based money laundering have been observed:

- Phantom Shipments; where no goods are actually shipped or delivered, but the invoices are promptly paid. What banker would even consider seeking confirmation of shipment and delivery, reasoning that it is the responsibility of the parties. In a legitimate transaction, he is correct, but not when there is trade-based money laundering in operation.
- Multiple invoicing; the money launderer creates multiple invoices for a single shipment, and processes the payments through a number of different banks that are not affiliated or related. Since again there is no verification of physical shipment, this method is rarely, if ever, discovered.
- Padding the quantity or quality; the money launderer send out a small shipment, but invoices a huge quantity, and/or high-quality goods.

Identification of the problem was originally difficult, because the bank's potential use of technical experts, if approved by management, whether they be in the private sector or in academia, was often too little and too late. Originally, I suggested that compliance officers see whether their bank had a client in the exact same trade or business, and consult with that client, anonymously of course, as to the proprietary aspects of the business. Money launderers running a bogus company would not generally adhere to industry practices, and they could be identified through those issues.

Money laundering problems often spawn solutions. Fortunately, one of those original professors who exposed this scheme eventually created a computer programme that represents the solution. It allows enquiries as to product and price, and advises whether the sales price is more than five per cent off the global market price of the same or similar goods. For details, go to: http://www.internationaltradealert.com/

Compliance officers at financial institutions whose clients are involved in international trade would be well advised, given the nature of trade-based money laundering, to see that these steps are part of the bank's standard procedure:

- Corporate documents are to be scrutinized whenever any new international trading client is accepted, and arrangements made to flag and examine high-volume payments on start-up companies that were recently incorporated. Don't forget to check the equivalent of Companies House, to ascertain whether this was an aged shelf company with prior accommodation officers, and no business conducted.
- Conduct personal visits to company facilities, on an unannounced basis. Are they really manufacturing something there? How many workers are on the job? Where are the company

officers?

- Due diligence enquiries on all named officers and directors, no matter how minor their roles may be. Have they a footprint on the Internet in this chosen industry?
- Know your customer's customer; the shippers or recipients/customers of the client should be the subject of due diligence enquiries. If the customer's customer is located in a tax haven country, or narcotics source or transit country, then enhanced due diligence is the order of the day.

To ensure that your compliance policies and procedures serve to identify and interdict suspected trade-based money laundering, remember to educate all front-line teller staff, as well as your compliance department.

J.D. University of Miami School of Law, 1973. Mr. Rijock is believed to be the only American professional who has been, in turn, a bank lawyer, career money launderer and compliance officer. He served two years in Federal Prison in the United States for Racketeering (RICO) and Money Laundering. His column "From a Different Angle" appears daily on the World-Check website www.world-check.com.