

Trade-based money laundering:

Where the risks lie for financial services firms



Background

Despite a significant proportion of international trade being conducted on 'open account' terms, firms' trade-based money laundering (TBML) controls typically focus on transactions supported by traditional trade financing, such as Letters of Credit. This is disproportionate and leaves a gap in the industry's response to TBML.

We believe it is **time for a new approach**. One that helps to alleviate the cost and growth pressures that have arisen under the current regime, and instead ...



... recognises how criminals abuse global trade to launder funds



... is proportionate to the risks, and



... protects the overall customer experience.



Why is action required?

- The documentary nature of trade means there is a lot of material available for due diligence when firms provide trade finance services. In comparison, trade conducted on open account terms is far less transparent. A combination of this 'greater visibility' in trade finance, along with a global regulatory focus on the area, has driven firms to restrict their focus on TBML risk to trade finance services only. This has led to some clients implementing **onerous trade finance compliance programmes**.
- Firms have become **increasingly risk averse**, and in some cases unable to service market segments reliant on trade finance services. In particular, small and medium sized enterprises (SMEs) are finding it ever harder to access the trade finance they (and the global economy) need to grow, with firms' approach to compliance being a contributory factor.
- A **significant opportunity** to unlock critical competitive advantage and improve the availability of trade finance services awaits those firms willing to embrace a bold and risk-based approach. Our clients are starting to do this, supported by a renewed focus on the risk-based approach being encouraged by the transposition of the EU's 4th Money Laundering Directive into the upcoming UK Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017.



Competitive advantage through compliance

An effective risk-based approach requires a focus on the actual threats posed that is agnostic to the divide between trade finance and open-account activity. This does not mean extending the existing controls environment within trade finance functions across open account activity, but rather a rebalancing of resource that reflects the profile of risk faced.

To combat TBML effectively, firms can build a clear picture of the illicit activities which make up TBML, and the typical data footprint these activities leave within their organisations. This information can be used to tailor an organisation's approach to monitoring which is both risk based and auditable. For example, the particular threats in relation to specific trade corridors can be analysed to develop a picture of specific TBML typologies that pose the most threat and the circumstances in which they are most likely to occur. Similarly, a focus on third party trade payments and whether these make sense in the context of what is already known about the underlying transaction can lead to potentially suspicious activity being identified that would have otherwise gone undetected.

Ultimately, the right focus can lead to greater efficiency through a rebalancing of resource to where it is needed most.

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What are the next steps?

A compliant approach, which is effective, proportionate and competitive, we believe depends on three key things:

- 1 **Establishing enterprise-level oversight of TBML threats to co-ordinate strategy.** This is critical to developing a co-ordinated top-down strategy and facilitating analysis of key data often restricted to departmental silos – such an approach will enable firms to relieve the pressure on trade finance, while ensuring the organisation is balanced in its approach to mitigating real risk
- 2 **Deployment of appropriate subject matter expertise when assessing risk and developing strategy.** In particular drawing upon the deep trade expertise that is often held within organisations to help define the TBML typologies to be monitored
- 3 **Leveraging data-analytics, robotic process automation and machine learning** as the backbone of operational strategy and future process enhancements

Overall firms must be bold in their application of a risk-based approach – understanding the motivations, methodologies and threats that drive trade crime, will be critical in this endeavour. The proceeds can then be shared: unlocking competitive advantage through reduced cost and increased efficiency within Trade Finance functions, while re-deploying some freed resource to plug the open account hole with data-driven, risk-based monitoring.



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"Firms can be bold in the approach they take, as long as it is logical and tailored to the risks they face. With the right approach, firms can unlock opportunities to cut cost and gain competitive advantage, whilst also keeping their global regulators happy."