



# Trade Based Money Laundering Challenges and Recommendations

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## Challenges for Banks

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- Defining banks' roles and responsibilities
- Determining a sound risk-based approach
- De-risking
- Assessing TBML Red Flags
  - Evaluating Market Price
  - Determining Dual Use Goods
  - Detecting Multiple Invoicing
  - Detecting Phantom Shipping
  - Identifying Shell Companies



# Defining Roles and Responsibilities



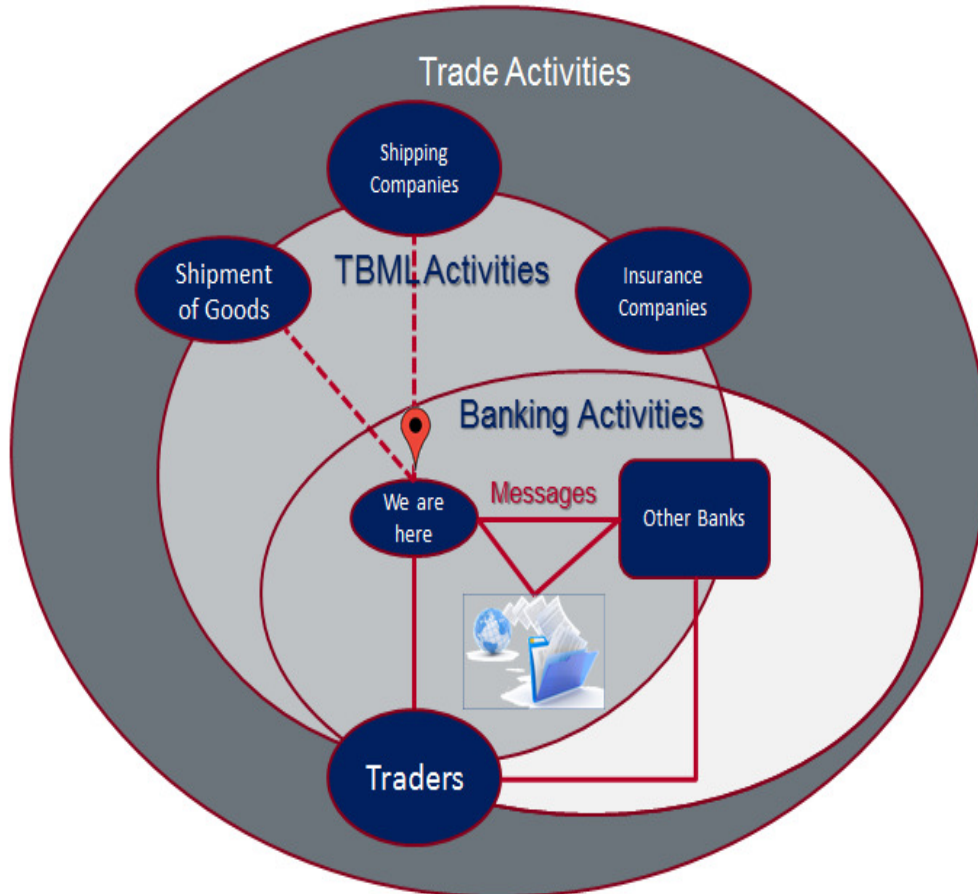
## Challenges

- Banks are more acquainted with their roles and responsibilities
- Banks are expected to expand their roles beyond their capabilities, e.g. like a policeman or an investigator
- Banks are expected to take more responsibilities than before
  - Banks can no longer deal with documents only
  - Banks can no longer deal with their customers only



# Defining Roles and Responsibilities

## Recommended Measures:



- Understand your bank's role in TBML activities
- Detect risk factors that have direct connection with your bank and conduct due diligence
- Conduct enhanced due diligence on the parties and activities with red flags
- Report suspicious activities



# A Sound Risk-Based Approach

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## Challenges

- Banks need to make greater effort in adopting a sound risk-based approach
- Banks tend to adopt rule-based approach
- Rule-based approach cannot address the rapid change in TBML techniques
- A sound risk-based approach requires more collaboration of AML compliance expertise and trade business expertise
- “Rule-based” vs “Risk-based” will continue to be an argument in combating TBML



## Why De-Risking is a Challenge?

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- Banks tend to lower their exposures to AML risk
- Bank's borrowers tend to prefer non-trade loans to trade loans
- Change of banks' and their clients' behaviors make TBML activities more difficult to detect
- Trade Finance is one of the top three areas mostly affected by the termination of RMA
- Trade Payments could be turning into the underground market and illegal money exchange services
- De-risking causes TBML activities to be more obscure and difficult to detect



# Case Study: Giving Up the De-Risking Decision



## Case Description

- A bank provides LC advising service to their on-shore corporate customers and overseas branches.
- The service may not be profitable but helps the bank keep a good and on-going relationship with their corporate and FI customers.
- Affected by the Correspondent Banking Definition, the trade finance business unit is required to stop advising LCs to 2<sup>nd</sup> advising banks without establishing correspondent relationship.





## Case Study: Giving Up the De-Risking Decision (cont'd)



### Action Taken by the Trade Finance Business Unit

- Define the bank's role in the LC advising service and who are their customers, considering the AML risk nature of such LC advising services, the guidance provided by HKAB and the industry practice, e.g. customer can either be the Issuing Bank or the Beneficiary of the LC.
- Discuss with compliance function and propose control measures
- Document the risk review process and decision with rationale
- Continue with LC advising service with appropriate controls



## Determining Market Price

Goods Description:  
Bicycle





## Challenges for Evaluating Market Price

- Market price is affected by four factors
  - Supply, Demand, Competition and Substitutes
- Historical market price is merely one of considering factors, but
  - The data is not specified for different grades of the traded products
  - Data is not publicly available for household goods
  - Bank staff do not have the product expertise to match the underlying goods with the correct historical market price data
- Actual selling prices are affected by
  - Terms of business relationship
  - Volume discounting
  - Specific quality



## Recommendations for Price Checking



- Collect price data from customers during the on-boarding stage
- Compare the collected data with publicly available market price data and define a reasonable pricing level/range for the customer
- Monitor the actual prices during transaction screening stage
- Review significant deviations from the collected price data and adjust the reasonable pricing level/range in case of need
- Keep updating the customer profile with the most reasonable pricing range



# Determining Dual-Use Goods

Factors Be Considered	Challenges for Banks
End-Usage and End-User	<ol style="list-style-type: none"><li>1. Documents seldom indicate end-usage and end-user of the goods</li><li>2. The availability of information on the end-usage and end-user of the goods on documents is subject to the exporter's decision and capability to provide such</li><li>3. Importers are more likely to know the end-usage and end-user of the goods, but the importer may not be a customer of the banks in all instances</li><li>4. Authenticity of information provided by non-customers is always in doubt</li></ol>
Export License Requirement	<ol style="list-style-type: none"><li>1. Certain dual-use goods can be traded with export licenses</li><li>2. Different countries have different requirements for export licenses</li><li>3. Banks have no knowledge of all countries' requirements regarding export licenses</li><li>4. Banks can only rely on customer's declarations regarding export license requirements</li><li>5. Banks' customers may have no knowledge about export license when they are importers</li></ol>



## Recommendation for Determining Dual-Use Goods

- Focus not only on customers and their transactions, but also on their counterparties
- Obtain necessary information on end-user, importing countries and export license requirements
- Document findings in customer profiles for future transaction screening
- Engage senior management for critical decisions based on bank's risk appetite
- Place special controls for examining export license requirements
- Conduct periodic transaction and customer monitoring



# Multiple Invoicing and Phantom Shipping

## Challenges

- Banks historically deal with documents only instead of goods or actual shipments
- Experienced and inexperienced staff need to be trained and be familiar with the red flag indicators
- Multiple invoicing and phantom shipping cannot always be detected from the physical trade documents alone
- Expectations for trade staff have not been defined within their capability and proficiency



# Multiple Invoicing and Phantom Shipping

## Recommendations

- Provide adequate and regular trainings to staff with document examination skills to observe these red flags
- Check with shipping companies if any suspicion related to shipment of goods is identified
- Conduct customer on-site visit and re-examine their business records for higher risk trade products
- Monitor customer's account activities periodically





# Identifying Shell Companies

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## Challenges

- Identification of any shell company during the on-boarding stage
- The banks' customers usually are not shell companies but stay vigilant to their counterparties
- Trade operations staff may not be equipped with adequate knowledge and skill for identifying shell companies
- Shell companies, as akin to strawmen and smurfs, are difficult to identify during the transaction screening stage



# Identifying Shell Companies

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## Recommendations

- Obtain information about customers' counter parties during the on-boarding stage
- Conduct enhanced due diligence at the on-boarding stage to identify if customer's counter party is a shell company
- Train trade operations staff to identify red flag indicators from trade documents
- Conduct customer on-site visits and re-examine their business records for higher risk trade products
- Monitor customers' account activities on an ongoing basis, having regard to the customer risk profile and background



# Looking Ahead

## Expectations for Banks

- Establish and review industry standards periodically
- Equip compliance functions with trade specialists internally
- Be proactive in discussing TBML issues with authorities, examiners and other banks

## Expectations for Authorities

- Partnership with the industry to improve trade transparency by enhancing sharing of information
- Share watchlists and criminal patterns
- Provide helpdesks to answer technical queries from the industry



## Takeaways

- Risk-based vs rule-based approach
- Documentary compliance vs extended obligations
- Trade specialist vs AML investigator
- De-risking vs establishing anti-TBML controls

*Thank  
you*

