› Point of View

Talking Trade:

Money Laundering and Fraud - the Silent Side of Trade Finance

Trade finance is widely acknowledged as vital to the health and well-being of the international economy, with The World Trade Organization[1] (WTO) estimating that 80 to 90% of global trade is reliant on this method of financing. As a result, it is important that the process runs seamlessly, efficiently and at all times is protected from the machinations of criminal groups - fraudsters and money launderers who might look to do it harm. Today, this is beginning to happen as agencies implement the latest data management and analytics solutions to tackle fraud and money laundering, but such is the scale and severity of the threat to trade finance that this roll-out needs to accelerate before the problem is brought fully under control.

When trade finance fraud does occur, losses incurred can run into millions of dollars. The Chinese regulatory authorities[2] announced in September 2014 that they had already uncovered almost $10 billion in fraudulent trade-financing deals during 2014 alone.

Adding fuel to the debate that trade finance fraud potentially results in significant losses, US NGO, Global Financial Integrity's recent report "Illicit Financial Flows from Developing Countries 2003-2012"[3], finds that developing and emerging economies lost US$ 6.6 trillion in illicit flows during the period under scrutiny. When you consider the report also highlights that trade mis-invoicing accounts for nearly 78% of those illicit flows, the scale of this figure highlights the severity of the problem with trade financing in this region.

Gauging the Drivers

So what makes the trade finance process such an attractive target for fraudsters and money launderers?

Fraudsters are enticed by the huge sums involved, whilst money launderers are enticed by the ability to hide and disguise their criminal activities, with little risk of discovery. However, both groups are focussed on the fragility of the human control methods and the current reliance on manual processes and paper documents. This means there is very little electronic data, making sophisticated, automated monitoring difficult and prone to false positives and inaccuracies. This, coupled with the complexities of trade, different languages and the multitude of organisations who trade, provides the criminals with all the materials they need to carry out fraud and AML abuse.

There is also inherent risk in international trade, which often causes uncertainty and tension between the exporter and the importer. The exporter wants payment as soon as possible, while the importer wants the goods urgently but also wishes to delay payment, generating income in the meantime to make payment to the exporter. This tense, febrile relationship creates an environment that can be conducive to fraud and financial crime.

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[1] Source: https://www.wto.org/english/thewto_e/coher_e/tr_finance_e.htm

[2] Source: http://www.wsj.com/articles/china-uncovers-more-than-10-billion-in-fraudulent-trade-financing-deals-1411620122

[3] Source: http://www.gfintegrity.org/wp-content/uploads/2014/12/Illicit-Financial-Flows-from-Developing-Countries-2003-2012.pdf

Growing Awareness

Today, we are seeing a growing understanding of the issue of trade finance fraud and money laundering and a mounting appreciation of its importance - with prominent voices across the world of business and politics airing their views.

According to John Cassara, former employee of America's Treasury department, trade is "the next frontier in international money-laundering enforcement," while Balesh Kumar of the Enforcement Directorate, an Indian agency that fights economic crime, claims that it is "a ready-made vehicle" for dirty money. Fuelling the debate still further, the UK's Financial Conduct Authority's (FCA) "Anti-money laundering annual report 2012/13"[4], published in July 2013, brings the issue to the attention of the major banks, arguing that most "were not giving adequate attention to money laundering red flags in trade finance transactions. There was an inconsistent approach to risk assessment and only a few banks had conducted a specific trade finance money laundering risk assessment."

In line with this finding, the growing awareness of the trade finance issue is not yet matched by a widespread understanding of current technology and software capabilities and how best to take action to tackle it.

Tracking the Methodologies

So why are the authorities finding it challenging to decide on a strategic approach and to pursue it single-mindedly? One of the main reasons is the vast range of trade finance frauds that exist today, all with their own specific characteristics and challenges to address. Double financing, among the most prominent and popular typologies used, involves importer and exporter organisations working together in collusion – either to create false turnover to obtain credit or to conduct a 'bust out' where both receive funding for the same trade and then subsequently disappear.

We are also witnessing an upsurge in simple frauds where importers or exporters falsify accounts to qualify for loans, with no intention of ever repaying the money. Other commonly deployed techniques, include hiding disqualified directors, opaque organisation structures concealing risky ownership structures (links to arms manufacturers for example), or shared ownership structures.

In terms of money laundering, the typical approach involves over or under-invoicing, over or under-shipping or simply shipping empty cargo containers and using this as a means to transfer funds internationally.

We are also seeing instances of benign goods being used for terrorist or drug manufacturing purposes, such as farm fertilizer to make bombs for example. The process of tracking this practice is known as "dual-usage monitoring" and organisations that trade in these goods should be monitored with increased scrutiny.

Challenges of Taking Action

In attempting to tackle fraud and money laundering associated with trade finance, the authorities need to process vast volumes of data, typically highly diverse in nature, much of which is unstructured and not effectively integrated with other information. The problem is compounded by the fact that they need to analyse it in granular detail right down to the quantity of goods in each container, as well as the shipping routes and times used.

The first challenge is pretty tough, but once this has been overcome there are peculiarities of trade that add an interesting dimension to the problem. This takes the form of internal short hand used by operational clerks, which can be different for each country and each Trading Bank, as well as the use of Chinese Commercial Codes which can add an additional layer of complexity when looking to identify who is making the trade and what is traded when and to where.

Equally, the quality of data in trade finance environments is often mediocre at best. Organisations involved generally concentrate far more on the operational requirements of loading and offloading cargos against tight deadlines, and the execution and facilitation of payments, rather than on considering how this data can be captured and used for compliance and fraud monitoring. Moreover, existing controls are more focused on fraud, with highly skilled clerks looking for irregularities by checking documents and the sparse electronic data available. These specialists have deep knowledge but lack the holistic view needed to overcome the deceptive tactics of criminals. As a result, most organisations struggle to develop a complete picture of operations within a single country, let alone the global perspective needed to understand an organisation's full fraud and AML exposure.

Putting a Solution in Place

Historically, the difficulties involved in tackling fraud and money laundering in the complex trade finance arena have been such that few organisations have addressed it effectively. So how can they rectify this and put an appropriate solution in place?

The first key step has to be to apply the latest data management and data cleansing solutions to existing data in order to develop a comprehensive picture of all relevant information.

[4] Source: http://www.fca.org.uk/static/documents/anti-money-laundering-report.pdf

The first step is a process of exploration and discovery but, once relevant data has been captured, it is critical that data quality methodologies are applied to it. Solution providers have tools that can help this process but that in itself is not sufficient. The banks also need to take responsibility for addressing the issues many of them still have with their data today. They need to put programmes in place to capture better data, starting with simple data capture and enhanced KYC data, through to more complicated Optical Character Recognition software to capture invoice and manifest information.

Businesses need to be pragmatic in the way they introduce sophisticated systems and look to incrementally add layers of complexity and context. They should not wait to get their data perfect. Instead, they should work with what they have right now and use a variety of techniques to improve their current controls, adding more data and context as the sources come online.

Organisations should use technology to enable their compliance and anti-fraud programmes, including visualisation techniques to identify patterns, anomalies and outliers. Money laundering and fraud are all about deception. Therefore to tackle them effectively, businesses need to make use of third party data sources to gain a complete picture of what is happening; run a multi-dimensional analysis of their data and start to identify areas of interest. Context is key to understanding and solving the fraud and AML problem, which means that anchoring data into real world constructs, ships, ports, goods, companies, directors, owners, etc. helps to de-mystify the problems and also provides meaningful business insight that can be re-used.

Once they understand 'what their data looks like', they can start to take the necessary steps to monitor and analyse it; delivering a comprehensive end-to-end monitoring system that effectively connects data internally across the organisation, externally from third party sources, ensuring full, consistent and robust risk coverage.

In this context, a best practice approach needs to focus on multiple stages in the monitoring and control lifecycle, with the ability to add more internal and external contextual information - all residing within a platform able to ingest and process these vast quantities of additional information quickly and efficiently.

For this kind of scenario big data analytical technologies such as Hadoop, combined with High Performance Analytical (HPA) tools, become a must. New features such as dynamic data exploration help investigators analyse and identify the problems. In parallel, data scientists can further improve detection quality by using a hybrid analytics approach: incorporating business rules and database searching to pinpoint criminal activity that is known to have already occurred.

And they can subsequently bring in anomaly detection, text mining, advanced analytics and social network analytics to identify previously unknown or complex transgressions, and map the organisational links between the fraudsters and money launderers.

With these new technologies, controlling alert volumes becomes easier as more contextual analysis can be conducted, enabling a multi-layered alerting approach and the application of more advanced techniques on both higher risk customers and/or high false positive scenarios, helping manage alert volumes and apply an effective risk-based approach.

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Positive Action Needed

Trade finance plays a vital role in the global economy and will continue to in the future. Yet, this fact is both its strength and its greatest weakness. The vast sums involved, and the large volumes of money and documents changing hands in any trade financing transaction, make the process vulnerable to attack from determined fraudsters and money launderers. When losses occur, they can run into millions of dollars.

Stakeholders are increasingly aware of these issues. Yet, this recognition is not yet accompanied by a widespread understanding or capability of how best to take action to tackle it. It's a complex area, with the authorities having to confront a wide range of typologies for both fraud and money-laundering, together with large volumes of potentially poor quality, unstructured data.

The good news is that solutions are now available that enable the authorities to tackle trade finance fraud and monitoring head on, starting with the latest data management and data cleansing tools, leading onto the implementation of comprehensive end-to-end monitoring systems and finally the latest high performance hybrid analytics solutions.

Taken together, these kinds of capabilities enable compliance teams to pinpoint behaviour that looks suspicious or that lies outside typical ways of doing business; take action to prevent this from happening and ultimately bring to justice the perpetrators of trade finance fraud and money laundering.

For more information please visit: http://www.sas.com/fraudfinancialcrime

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