

AML COMPLIANCE

PATRIOT Act, BSA, FinCEN, Terrorism Financing, SARs, Risk Analysis and More

Alert

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In This Issue ...

Trade Finance:

Use These Research-Based Measures To Stem The Trade-Based Money-Laundering Tide.

Last month **Eli** alerted you to the rising money-laundering threat posed by illicit trade finance; this month, we prep you to fight back. Turn the page to get trade finance basics down pat and obtain expert advice on trade-finance investigation procedures. **(Page 34)**

Crime Trends:

Trade Finance Crimes Are Up: Find Out Which Geographies And Products Are High Risk.

Here's a look at the surprising volume of funds that criminals laundered through some countries and custom districts in 2006, as well as clues to which products are high-risk. **(Page 35)**

FACTA Compliance:

Prevent Identity-Theft With These 4 Program-Building Tips.

The Nov. 1 identity-theft prevention program implementation deadline will be here before we know it. Consider the following pointers before your institution considers the new requirements met. **(Page 36)**

FACTA Tip Sheet:

Meet New Identity-Theft Prevention Requirements And Boost Detection With This Tip Sheet.

Complying with the new Fair and Accurate Credit Transactions Act (FACTA) requirements doesn't have to be an implementation nightmare. Review these basics to make sure your institution is on the right track. **(Page 36)**

Regulatory Update:

Tune In To This Month's Regulatory Roundup To Tune Up 'Foreign Corruption' SARs.

Whip SAR filing into shape and crack down on global malfeasance with this newly issued guidance from **FinCEN**. **(Page 37)**

Terrorism Financing:

Keep Terrorist Financing In Check By Lifting Lessons From These Real-Life Cases.

Use these examples to improve your staff's ability to recognize transactions related to terrorist financing: **(Page 38)**

CONTENTS

<i>Trade Finance</i>	34
<i>Crime Trends</i>	35
<i>FACTA Compliance</i>	36
<i>FACTA Tip Sheet</i>	36
<i>Regulatory Update</i>	37
<i>Terrorism Financing</i>	38
<i>Industry Notes</i>	40
<i>Editorial Page</i>	40

INDUSTRY NOTES

► EXPECT CHANGES SOON TO CTR REPORTING EXEMPTIONS	40
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We welcome your comments and suggestions!

Stacie Majoria, MA
Executive Editor
919-285-4465
staciem@eliresearch.com

John MacKessy, CAMS
Consulting Editor
FTI Consulting

Kimberly Gilbert, MFA
Managing Editor
kimberlyg@eliresearch.com

TRADE FINANCE

Use These Research-Based Measures To Stem The Trade-Based Money-Laundering Tide

► **Hint: Start with character-based auditing; if necessary, proceed to transaction auditing.**

Last month **Eli** alerted you to the rising money-laundering threat posed by illicit trade finance; this month, we prep you to fight back. Read on to get trade finance basics down pat and obtain expert advice on trade-finance investigation procedures.

Wisen Up To Inflated Prices And Deflated Values

Moving illicit proceeds through the trade system happens one of two ways: through overvalued imports or undervalued exports, explains **John Zdanowicz**, president of **International Trade Alert, Inc.** and **Florida International Banker's Association** professor of finance at **Florida International University**.

Undervalued exports: With the undervalued export technique, criminals facilitate cross-border proceeds transfers by first converting illicit cash into goods. *Example:* A drug-dealer uses \$1 million in cash to buy 200 gold watches at \$5,000 a piece. He then exports them to a coluding partner in a foreign country but only bills the recipient \$5 per watch for a total of \$1,000. The foreign partner then sells the watches for the market rate of \$5,000 a piece to recollect \$1 million in liquidity, describes Zdanowicz.

Overvalued imports: With this method, money launderers move illicit funds out of the country disguised as payments for goods. *Example:* A foreign partner buys 10,000 pencils at .10 cents a piece, spending a total of \$1,000. However, he invoices the U.S. recipient for \$100 a pencil, so that the U.S.-based individual can gain authorization to wire \$1 million dollars abroad, says Zdanowicz.

Evolving tactics: An additional trade-based money-laundering method is invoicing goods or services multiple times, according to the **Financial Action Task Force's** June 2006 Trade Based Money Laundering study. Unlike over- and under-invoicing techniques described on this page, paying multiple invoices for one shipment may not require the exporter or importer to misrepresent the price of the good or service on the commercial invoice. In this case, you'll have to depend on account-level analysis of the payor and payee. **Resource:** <http://www.fatf-gafi.org/dataoecd/60/25/37038272.pdf> ■

Bank's role: According to the **Federal Financial Institutions Examination Council** (FFIEC) manual, financial institutions must determine if traded items are obviously over- or under-valued, based on general knowledge.

Problem: Nobody knows the relevant price range for every imported and exported good — there are more than six million combinations of product codes and countries, points out Zdanowicz. Obviously, anybody would know that \$5 for a gold watch or \$100 for a pencil is highly suspect. However, the truth is it's difficult for banks to determine whether most products they see are over- or under-valued without doing intensive analysis of U.S. trade data, contends Zdanowicz.

Check For Red Flags, Then Do Price Checks

First step: It's not feasible to index the product price on every single transaction and, furthermore, the FFIEC manual states that you should have probable cause to check the price, Zdanowicz points out. That's where character-based auditing — or a risk-based approach to verifying prices — comes in, he says.

When a client asks your bank to issue a letter of credit, consider whether the transaction involves a high-risk geography or product category. Specifically, character-based auditing means you should:

Evaluate the country risk — Estonia and Afghanistan, for example, are high-risk nations.

Assess the product risk — mechanisms for music boxes, bare earth metals and radioactive isotopes are among commonly over- or under-valued goods.

Index the customs district risk — Norfolk, VA and Cleveland, OH are two of the riskiest customs jurisdictions, according to 2006 data Zdanowicz analyzed.

Next step: If you come up with two or more red flags, proceed to transaction auditing (checking the goods' usual price), advises Zdanowicz. By analyzing the U.S. trade database, you can get a sense of normal versus abnormal product price ranges, he says.

Option 1: You can purchase access to the U.S. trade database from the Department of Commerce's Bureau of Census, Zdanowicz shares. With this method, you will have

continued on next page

CRIME TRENDS

Trade Finance Crimes Are Up: Find Out Which Geographies And Products Are High Risk

Trade finance is the next generation of money laundering, and it's no secret that you'll have to work hard to keep up with this sophisticated tactic. Here's a look at the surprising volume of funds that criminals laundered through some countries and custom districts in 2006, as well as clues to which products are high-risk.

High-Risk Customs Districts	Under-Valued Exports, 2006	Over-Valued Imports, 2006
Cleveland, OH	\$3,723,789,413	\$3,774,890,944
Norfolk, VA	\$4,366,882,223	\$1,186,220,163

High-Risk Product Destinations/Origins	Under-Valued Exports, 2006	Over-Valued Imports, 2006	Total Moved Out of the U.S., 2006
Hong Kong	\$4,123,850,325	\$320,994,681	\$4,444,845,006
Switzerland	\$2,157,428,386	\$1,144,059,238	\$3,301,487,624
Costa Rica	\$1,445,824,661	\$78,682,399	\$1,524,507,060

High-Risk Products	Total Funds Moved Out of the U.S. through over- or under-valued shipments, 2006
Optical Fibers, Optical Fiber Bundles and Cables	\$1,956,532,697
Radioactive Elements and Isotopes	\$1,617,767,386
Recorded Media for Reproducing Sound or Image	\$1,567,385,322

Source: John Zdanowicz, president of **International Trade Alert, Inc.** and finance professor at **Florida International University**, who has developed software to analyze the U.S. trade database. ■

continued from previous page

to expend resources to evaluate the raw data for trade-based money laundering trends and build statistical filters to determine whether items are under- or over-invoiced.

Option 2: Or you can choose to work with a company that has done the data analysis, suggests Zdanowicz, who spent years developing a software product called the

International Price Profiling System to speed in-depth analysis of the U.S. trade database.

Bottom line: Protect yourself from trade-based money laundering involvement by knowing what geographies and products are likely to be part of illicit activity and getting your hands on current price-comparison data. If you perform a transaction audit, remember to document your analysis and your SAR/No SAR decision. ■