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Mitigating the trade-based money laundering risk

In June 2006 the Financial Action Task Force (FATF) released the first comprehensive report on Trade-Based Money Laundering which stated that “The international trade system is clearly subject to a wide range of risks and vulnerabilities that can be exploited by criminal organisations and terrorist financiers.” One of the key findings of the FATF report was that trade data analysis is a useful tool for identifying trade anomalies and can lead to the investigation and prosecution of trade-based money laundering cases.

The good news is that trade data may be acquired from the U.S. Department of Commerce’s Bureau of Census. Released monthly, the United States Merchandise Trade Data Base contains the detailed information related to all U.S. import and export transactions. The data set includes information on the country of import or export, product descriptions and code numbers, the U.S. Customs District of import or export, the quantities and dollar values of the transactions. This is the same database used to determine the monthly U.S. balance of trade. The analysis of this data base can assist financial institutions with mitigating trade financing risk.

Character-based analysis

The FFIEC BSA/AML Examination Manual stipulates that financial institutions engaged in trade financing conduct both character-based and transaction-based analysis. Transaction-based analysis is the evaluation of import or export prices to determine “obvious over- or under-pricing of goods and services”. The analysis of the U.S. Merchandise Trade Data Base can produce statistical price filters to assist financial institutions with detecting abnormally priced products.

However, before conducting the complex price analysis, financial institutions should conduct character-based analysis to determine if further and more extensive analysis is warranted. According to the FFIEC, “Unless customer behavior or transaction documentation appears unusual, the bank should not be expected to spend undue time or effort reviewing all information”. The analysis of trade data will provide filters to determine suspicious transactions that should be evaluated in more detail.

Character-based analysis requires a financial institution to evaluate the non-price characteristics about the financing transaction, such as: the risk of the country of import or export, the risk of the product, the client’s appearance on PEP lists, or the results of OFAC filtering. Many of the existing “Know Your Customer” policies can be applied to international trade financing activities. The FFIEC provides guidance to assess the appropriateness and comprehensiveness of a bank’s customer due diligence (CDD) policies, procedures, and processes.

Risk profiles

The analysis of the U.S. trade data base will assist financial institutions with identifying trade financing transactions that should be investigated in more detail. Various risk profiles can be determined by evaluating recent U.S. international trade transactions, such as:

Country Risk Index: A risk profile of every country in the world, based on the most recent 12 month abnormal pricing history in the country's international trade.

Product Risk Index: A risk profile of every product classification, based on the most recent 12 month abnormal pricing history of that product.

U.S. Customs District Risk Index: A risk profile of every U.S. Customs District, based on the most recent 12 month abnormal pricing history of transactions in the customs district.

Each risk index is based on the analysis of every U.S. import and export transaction, for all products, countries, and U.S. customs districts. The analysis is based on the Internal Revenue Service's 482 Transfer Pricing Regulations which define arms-length pricing in international trade. The risk indices can be updated every month as new U.S. trade data is released to the public.

The details of the Product Risk Index and the Customs District Risk Index will be presented in a subsequent article in Money Laundering Alert.

Country risk index

An analysis of the total dollar value of abnormal international trade pricing by country is detailed in Table 1. Table 1 contains a sample of the dollar amount of money moved out of the U.S. in 2004 through undervalued exports and overvalued imports for the top 25 countries (out of 218 countries) that trade with the U.S. This analysis shows that the largest amount of money being moved out of the U.S. corresponds to the largest U.S. trading partners. This analysis may not be useful in identifying high risk countries.

However, Table 2 contains a sample (top 25 out of 218 countries) of the Country Risk Index for 2004 which measures the money moved from the U.S. to all countries in the world as a percentage of their trade with the U.S. This type of character-based analysis will provide the bank with an indication that a more detailed analysis is warranted. An analysis of the Product Risk Index and the Customs District Risk Index will provide additional evidence regarding the risk of financing the transaction.

For a free copy of a Country Risk Index report contact International Trade Alert.

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TABLE 1

**TOTAL MONEY MOVED OUT OF THE UNITED STATES BY COUNTRY
DOLLAR VALUE - (THROUGH UNDER-VALUED EXPORTS AND OVER-VALUED IMPORTS)**

Year: 2004

(Data obtained from the U.S. Census Bureau.)

By Country

Obs	COUNTRY	UNDER-VALUED EXPORTS	OVER-VALUED IMPORTS	TOTAL MOVED OUT OF THE US	SHARE OF TRADE
1	CANADA	\$11,039,683,286	\$7,256,738,049	\$18,296,421,335	4.12%
2	JAPAN	\$8,151,814,635	\$5,974,212,167	\$14,126,026,802	7.68%
3	CHINA	\$6,007,716,795	\$7,800,914,990	\$13,808,631,785	5.97%
4	MEXICO	\$8,785,360,653	\$4,192,936,064	\$12,978,296,718	4.87%
5	FR GERM	\$6,407,989,714	\$5,433,984,370	\$11,841,974,084	10.90%
6	U KING	\$7,594,995,153	\$2,484,349,794	\$10,079,344,947	12.24%
7	KOR REP	\$5,816,253,001	\$1,425,414,117	\$7,241,667,118	9.99%
8	FRANCE	\$3,897,833,867	\$1,625,064,324	\$5,522,898,191	10.41%
9	TAIWAN	\$3,094,430,949	\$1,698,479,949	\$4,792,910,898	8.51%
10	SINGAPR	\$3,636,170,934	\$713,527,417	\$4,349,698,351	12.46%
11	PHIL R	\$3,398,036,934	\$512,074,712	\$3,910,111,646	24.11%
12	MALAYSA	\$2,317,172,101	\$1,201,554,685	\$3,518,726,786	9.00%
13	BELGIUM	\$3,126,261,045	\$345,127,901	\$3,471,388,946	11.84%
14	IRELAND	\$1,129,283,725	\$2,266,965,110	\$3,396,248,835	9.54%
15	HG KONG	\$2,937,782,192	\$347,808,479	\$3,285,590,672	13.08%
16	NETHLDS	\$2,550,432,078	\$526,550,514	\$3,076,982,591	8.34%
17	ITALY	\$1,536,748,889	\$1,489,132,352	\$3,025,881,241	7.80%
18	SWITZLD	\$2,277,817,712	\$735,336,191	\$3,013,153,903	14.41%
19	BRAZIL	\$2,376,524,681	\$555,731,959	\$2,932,256,640	8.37%
20	INDIA	\$1,791,009,935	\$505,472,160	\$2,296,482,094	10.60%
21	AUSTRAL	\$1,821,607,280	\$257,314,622	\$2,078,921,902	9.53%
22	THAILND	\$1,181,887,099	\$729,875,756	\$1,911,762,854	7.99%
23	DENMARK	\$1,451,172,673	\$432,241,119	\$1,883,413,791	31.26%
24	ISRAEL	\$1,004,123,800	\$456,182,415	\$1,460,306,216	6.16%
25	SWEDEN	\$775,593,211	\$469,080,673	\$1,244,673,884	7.80%

TABLE 2

COUNTRY RISK INDEX – 1/1/2004 TO 12/31/2004

**TOTAL MONEY MOVED OUT OF THE UNITED STATES BY COUNTRY
(THROUGH UNDER-VALUED EXPORTS AND OVER-VALUED IMPORTS)
RANK ORDERED BY PERCENT OF TRADE**

(Data obtained from the U.S. Census Bureau.)

By Country

	COUNTRY	UNDER-VALUED EXPORTS	OVER-VALUED IMPORTS	TOTAL MOVED OUT OF THE US	SHARE OF TRADE
1	AZERBJN	\$528,389,802	\$157,416	\$528,547,218	268.54%
2	YUGOSLV	\$169,598,049	\$741,061	\$170,339,110	72.49%
3	IRAN	\$152,952,617	\$12,628,410	\$165,581,027	70.03%
4	CUBA	\$247,970,745	.	\$247,970,745	61.91%
5	KAZAKHS	\$291,952,547	\$7,378,273	\$299,330,820	34.90%
6	BULGAR	\$214,509,017	\$14,467,039	\$228,976,056	33.72%
7	ESTONIA	\$156,854,211	\$9,510,139	\$166,364,350	31.52%
8	DENMARK	\$1,451,172,673	\$432,241,119	\$1,883,413,791	31.26%
9	BARBADO	\$99,437,204	\$820,250	\$100,257,454	26.08%
10	PHIL R	\$3,398,036,934	\$512,074,712	\$3,910,111,646	24.11%
11	ANTIGUA	\$31,027,519	\$1,270	\$31,028,789	23.94%
12	LIBERIA	\$813,897	\$33,439,992	\$34,253,890	23.64%
13	B VIRGN	\$24,263,203	\$13,856	\$24,277,059	21.11%
14	AFGHAN	\$38,156,092	\$96,595	\$38,252,686	20.95%
15	ANDORRA	\$2,416,758	\$21,034	\$2,437,792	19.44%
16	KENYA	\$129,810,252	\$7,197,135	\$137,007,387	18.36%
17	POLAND	\$429,068,286	\$52,566,628	\$481,634,914	17.47%
18	SLVENIA	\$102,026,329	\$18,606,648	\$120,632,978	17.13%
19	CZECH	\$350,028,716	\$62,282,789	\$412,311,505	15.96%
20	SWITZLD	\$2,277,817,712	\$735,336,191	\$3,013,153,903	14.41%
21	HG KONG	\$2,937,782,192	\$347,808,479	\$3,285,590,672	13.08%
22	ARAB EM	\$639,817,694	\$22,463,911	\$662,281,605	12.72%
23	TURKEY	\$889,053,935	\$163,868,214	\$1,052,922,150	12.69%
24	PORTUGL	\$343,236,195	\$72,192,340	\$415,428,535	12.63%
25	BURKINA	\$2,834,423	\$75	\$2,834,498	12.56%