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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 colluding 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.

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

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}
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.

<table>
<thead>
<tr>
<th>High-Risk Customs Districts</th>
<th>Under-Valued Exports, 2006</th>
<th>Over-Valued Imports, 2006</th>
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</thead>
<tbody>
<tr>
<td>Cleveland, OH</td>
<td>$3,723,789,413</td>
<td>$3,774,890,944</td>
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<tr>
<td>Norfolk, VA</td>
<td>$4,366,882,223</td>
<td>$1,186,220,163</td>
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<tbody>
<tr>
<td>Hong Kong</td>
<td>$4,123,850,325</td>
<td>$320,994,681</td>
<td>$4,444,845,006</td>
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<tr>
<td>Switzerland</td>
<td>$2,157,428,386</td>
<td>$1,144,059,238</td>
<td>$3,301,487,624</td>
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<td>Costa Rica</td>
<td>$1,445,824,661</td>
<td>$78,682,399</td>
<td>$1,524,507,060</td>
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<tr>
<th>High-Risk Products</th>
<th>Total Funds Moved Out of the U.S. through over- or under-valued shipments, 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Optical Fibers, Optical Fiber Bundles and Cables</td>
<td>$1,956,532,697</td>
</tr>
<tr>
<td>Radioactive Elements and Isotopes</td>
<td>$1,617,767,386</td>
</tr>
<tr>
<td>Recorded Media for Reproducing Sound or Image</td>
<td>$1,567,385,322</td>
</tr>
</tbody>
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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.

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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.