MINI-ROUNDTABLE

TACKLING TRADE BASED MONEY LAUNDERING (TBML)
PANEL EXPERTS

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**Adam Meshell** has 10 years of experience in the financial services industry serving global banking and capital markets clients in the areas of risk, regulatory compliance, anti-money laundering and fraud prevention. He is EY’s global solution leader for trade finance risk analytics and also oversees the firm’s Know Your Customer (KYC) technology and managed service solutions.

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**Michelle Fisser** has more than 18 years of experience in the financial services industry including 13 years working as a compliance officer for several international financial institutions. This includes acting as a global compliance officer for trade & commodity finance within a large FI. Within FIDS Netherlands, she drives the FINCRIME compliance practice focusing on the financial sector. This includes building, implementing and validating FINCRIME programmes, such as AML and trade finance sanction reviews using new technology solutions.

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**Hong Hui Wong** has more than nine years of experience in financial crime compliance at top tier banks. As an executive director in EY’s financial crime team, he focuses on sanctions and anti-money laundering (AML) compliance advisory. He has worked with major regulators in the US, the UK and Asia and conducted multiple AML/sanctions compliance control reviews under a regulatory mandate.
R&C: To what extent are financial institutions (FIs) being impacted by trade based money laundering (TBML) activity in today’s business world? Has this risk increased in recent years?

Meshell: In today’s highly-connected global economy, FIs are looking to increase their market share in international trade by linking importers and exporters to provide financing, letters of credit, insurance and other sophisticated products – through export factoring and forfaiting, for example. With the World Trade Organization forecasting trade growth of over 4 percent in 2018, FIs should expect to increase their share of trade-related transactions and, as a by-product, their exposure to potential fraud and TBML. In addition to an increase in overall trade-related activity, the majority of trade happens under open account terms, where FIs have significantly less insight into the underlying purpose of the transaction, as opposed to directly financing the deal. Moreover, studies performed in 2017 by Global Financial Integrity show a substantial uptick in illicit activity facilitated through global trade, especially in developing countries. Global Financial Integrity estimated that the amount of illicit activities flowing to and from global markets is more than US$1 trillion. When you combine these activities with an increase in overall trade – and FIs’ general lack of transactional insight – FIs will be challenged to mitigate significant risks.

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R&C: Have any recent regulatory efforts been made to curb TBML? What penalties can FIs expect to face if they are deemed to have facilitated criminal activity, knowingly or otherwise?

Fisser: Several recent regulatory enforcement actions by US regulators indicate an increased focus on TBML activity. The focus, however, extends beyond the US. Asia is a major manufacturing hub and logistics centre, and Asian regulators, such as the Monetary Authority of Singapore (MAS) and the Hong Kong Monetary Authority (HKMA), have repeatedly expressed interest in making sure FIs are preventing
TBML. The most notable penalties have come largely from the Office of Foreign Asset Controls (OFAC). Trade activity has significant sanction risk due to the number of interrelated factors that must be analysed, such as vessels, vessel routes and multiple parties involved in any trade-related transaction. As most FIs know, OFAC has zero tolerance for processing transactions with sanctioned countries. This is further complicated by financial criminals increasingly using transhipment through non-sanctioned countries as a means to get products to sanctioned countries. As some of the more innovative FIs improve their risk controls through advances in technology and analytics and display positive outcomes, all FIs should expect to be held to a higher standard that leverages the latest technology to monitor for risk, as opposed to operationally-intensive manual processes.

**R&C: How important is knowing your customer as a control against TBML?**

**Wong:** Know Your Customer (KYC) is a vital component of any anti-money laundering programme, especially one looking to control TBML. A comprehensive KYC programme creates a foundational understanding of the activity and partnerships the customer should be reasonably expected to engage in. This becomes a vital feedback loop into the FI’s monitoring programme. For TBML specifically, expanding beyond just KYC to understand trading partners, vessels and products being shipped is necessary to effectively identify TBML. A significant portion of TBML comes in the form of fraudulent invoicing. A solid appreciation for the goods FIs’ customers are trading, and a reasonable cost of those goods, is the first step to understanding the inherent risks. Having a constant view of historical activity and grouping customers into clusters or segments will also help combat fraudulent invoicing.

**R&C: What other measures can be taken to implement appropriate controls to shut down TBML channels?**

**Meshell:** In addition to knowing their customers, FIs also must take proactive steps to recognise a specific transaction that may present risk, including vessels, containers and products. As an example, transhipment has been a major focus of criminal activity and regulators alike, as a means to supply goods into sanctioned countries. Identifying and documenting vessel and cargo information, including shipping routes, container and vessel types, will provide investigators with the means to determine whether the information aligns to what would be expected for a specific shipment. Given the risks embedded in trade finance, placing tighter controls on trading partners and customers with indicators, such as anti-money laundering (AML) risk ratings, will enable FIs to engage in more consistent reviews of the customer profile and allow compliance and business personnel to stay tightly connected.
**R&C: How important are effective and comprehensive risk assessments as a control for TBML?**

**Fisser:** As with any product or business line within a bank, executing an effective risk assessment will help improve controls in high-risk areas. A risk assessment can achieve a number of objectives to support risk controls, including engaging the business and acknowledging where inherent risk may be present, identifying what controls are working well and what controls would benefit from more improvement, and documenting improvements for internal and external examiners that the risks are being sufficiently covered by existing controls.

**R&C: Do you believe FIs need to do more to build accurate customer profiles and review transactional activity? Is data collection and analysis an integral element?**

**Wong:** FIs must leverage advancements in technology to bring disconnected controls together. FIs are improving their KYC capabilities across the board, but the feedback into the monitoring processes is vital to making KYC a relevant control against ongoing TBML risk. FIs should understand what data is required to assist them in identifying transactional risk and work these risks into their customer due diligence standards. In trade finance, this is especially important due to the complexity and multilayered nature of transactions. FIs must ask themselves whether the data they gather on customers and transactions can support some basic questions. Does the product my client is purchasing fit its profile? Does the shipping location of the product make sense based on its geography? Does the customer’s use of a transhipment make sense considering similar activity by other clients? If the KYC and aggregated transaction data cannot answer this type of inquiry, it will be difficult for FIs to put forth an effective programme.

**R&C: What benefits can technology bring to the process? How effective has it proven in terms of detecting and analysing TBML trends, for example?**

**Meshell:** Technology is playing an increasingly significant role in the detection of TBML. The use of analytics, such as artificial intelligence, machine learning and natural language processing as a predictive measure of risk, is becoming an effective tool in the compliance space. There is no better use case than trade finance to show the benefits of why many believe it will be the future of transaction monitoring. Given the heavy documentary nature of a trade transaction, much of the data being extracted is unstructured and unsuitable for traditional monitoring tools. There are three key
technologies that will continue to develop and play a large role in improving risk controls: optical character recognition (OCR) to extract data from documents, robotic process automation to move the data into downstream compliance processes, and advanced analytics to perform complex risk analysis and drive the level of review required for a particular transaction. Technology that is more flexible and adaptable to a changing risk profile is also vital, not only to detect evolving risk, but to do so in a manner that keeps costs down for FIs. Risk profiles are changing rapidly, especially with the rise of financial products and payment mechanisms such as cryptocurrencies. The US Drug Enforcement Agency (DEA) stated in 2017 that many Chinese manufacturers are accepting cryptocurrency as a form of payment. FIs that are serving or plan to serve these manufacturers must be able to quickly ramp up risk controls and adapt as quickly as their customers.

**R&C: What considerations do FIs need to make when drafting and rolling out policies and procedures to tackle TBML? Are there any common pitfalls or oversights, in your experience?**

**Fisser:** Several key areas of risk must be controlled: sanctions, AML, fraud, anti-boycott and military or dual-use goods. Having a clear set of red flags for each of these risk categories, and training the analysts who are processing the transactions to specifically look for these flags, is vital to conducting the appropriate level of review. A common pitfall in trade finance is leveraging basic AML policy and training which does not give front office and operational personnel insight into trade-specific risks. A tailored set of policy and associated procedures and communications delivered to impacted employees will help quell TBML from the ground up. Last but not least, the business should be involved in the development of all processes in order to create a policy framework that is broadly recognised and emphasised within the organisation.

**R&C: Where in the organisational structure of FIs should the responsibility lie for managing and preventing TBML?**

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for tackling TBML reside? How should FIs go about designating roles and responsibilities, and educating staff appropriately?

**Wong:** A delicate balance is needed to properly mitigate TBML risk between operating a centralised AML function and leveraging teams specifically focused on trade finance. The first line of defence resides within the business and operations part of the organisation, and interacts with the customer and reviews initial submissions of documentation. This first line is key to mitigating the risk because it is in the front line and positioned to see events or actions that data may not identify, such as a customer acting in a suspicious manner, or missing information or documentation with concealed information. Empowering business and operations with the right tools, training and responsibility to take action will be the most effective way to mitigate AML risk. Compliance departments can become more adept at identifying TBML by learning new typologies, taking lessons learned from other regulatory actions, and sharing information with peer institutions, because it is vital that there is transparency with valuable customer data and information.

**R&C:** What essential advice can you offer to FIs on improving their systems and processes to reduce their exposure to TBML activity?

**Meshell:** Embrace the technology innovation that is occurring. FIs exploring the use of technologies such as OCR and analytics across the enterprise, and applying it to detect TBML, has proven to be an important use case to demonstrate the value of such emerging technology. The ability to tie an entire transaction together, which may entail several events over a period of time with changes to key people, vessels or geographies, will make for effective monitoring. It is important to combine the aspect of human intelligence with the increasing use of advanced technology. Focusing human intelligence

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on investigating transactions that are truly indicative of risk, as well as allowing them to foresee emerging risk, and applying that feedback into the technology, will ultimately create a truly effective compliance programme in the trade organisation.

**R&C:** What are your expectations for TBML activity, and the risks it poses to FIs, in the months and years to come? Is this set to remain a key risk area that demands adequate attention and resources?

**Fisser:** The world continues to become a more closely-connected entity, and that results in companies and people collaborating, communicating and transacting in higher volumes and in more non-traditional methods than ever. To that end, bad actors will continue to find new ways to use the global financial system, specifically international trade, to conduct illicit activity. Given the scale and volume of transactions, the cross-border nature of the activity, and the current challenges that exist in mitigating such illicit activity, our belief is that regulators will continue to put significant focus in this space. The opportunity for disruption of the status quo has never been higher, and FIs will need to innovate by combining advancements in technology with human intelligence to keep pace with the growing wave of regulatory expectations and truly prevent financial crimes from taking place. We see opportunities to use blockchain for trade finance where FIs, clients and regulators support the development and leverage the efforts of others. This should not only lead to less abuse of trade finance and reduce TBML, but also lead to process improvements for trade finance in the broader sense. **RC**