

AN OVERVIEW OF TRADE-BASED MONEY LAUNDERING

Authors: Alan Craig and Rebekah Barthet

MONEY LAUNDERERS ARE ALWAYS FINDING CREATIVE WAYS TO LAUNDER PROCEEDS OF CRIME WITHOUT BEING EXPOSED. IN DOING SO, THEY GO THROUGH CONSIDERABLE EFFORT (AND CREATIVITY) TO DISGUISE THE PROCEEDS OF THEIR ACTIVITY UNDER THE COVER OF A LEGITIMATE BUSINESS ACTIVITY.

As Malta became an increasingly attractive choice for international investors, the country's financial services sector grew considerably in the past years. Over time, various entities, some with limited substance, were incorporated, raising the risk of Malta being used as a channel to launder the proceeds of crime.

It would be wrong to think that Malta's attractiveness lies only in its tax system. Paradoxically, money launderers may be quite happy to pay tax. Their prime motivation is to distance the funds from their illicit activity (layering process) with the ultimate aim of integrating ill-gotten funds (albeit net of the laundering costs) into the financial system, for them to use freely.

What is trade-based money laundering?

The Financial Action Task Force defines trade-based money laundering (TBML) as "the process of disguising proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins". The focus is not on the movement of goods, but rather on the movement of funds which requires collusion between parties. These schemes usually involve professional money launderers, such as lawyers or accountants, who provide parties the expertise to disguise the source of funds and avoid detection, in exchange for a fee or commission.

Goodwilled accountants, corporate service providers and lawyers may unwittingly find themselves at the centre of a cross-border TBML scheme. Understanding the purpose of business, along with professional scepticism and an eye for detail, are some of the main weapons practitioners have in their armoury.

Typical red flags for accountants to look out for

The following is a non-comprehensive list of some traits that may indicate the existence of a TBML scheme. One swallow does not necessarily make a summer, yet the existence of some of these traits may require closer analysis.

- Volume of goods being shipped appear to be much larger than the regular business activity;
- Goods are transported from or to a high-risk jurisdiction;
- Payment of goods is made by third parties who do not appear to have any connection with the transaction;
- Goods shipped are considered to be high-risk goods for money laundering, or goods connected to high-risk industries;
- Discrepancies between the description of goods on the bill of lading and those included in the invoice;
- Goods are transported through jurisdictions or entities for no apparent reason;
- The goods purchased are sold immediately, typically to one or a few customers, with a back-to-back type of arrangement;
- Credit terms are provided loosely without the expected levels of commercial guarantees and security in place;

- Credit terms do not elicit the commensurate commercial reaction expected in an arm's length transaction;
- The buyer and/or seller does not demonstrate the necessary experience and/or standing to carry out such a transaction;
- Communications are not carried out directly with the buyer and/or seller, but through an agent.

Case study (*)

A Maltese individual, a management consultant, owns a company registered in Malta. It has no employees and holds a bank account in Romania. The entity was established a month prior to purchasing used specialised construction equipment from a supplier in Germany for €6 million (on credit). No technical and commercial due diligence was undertaken by the Maltese entity prior to the acquisition of the equipment. Only limited correspondence with representatives of the German entity was noted. The equipment was immediately re-sold to a customer located in Turkey for €6.1 million, with the same credit terms. The equipment was shipped directly from Germany to Turkey. The proceeds were channelled to the Maltese entity by the Turkish customer, with a commission withheld, prior to transferring the remaining funds to the German supplier. Delays were encountered in the scheduled payments for both the purchase and re-sale of the equipment without valid due notice, justification and follow-up. Desktop research reveals that the German supplier is an established player in the construction industry. Correspondence reviewed indicates that the supplier shares the same legal advisors and correspondence address with the Turkish customer.

An analysis of this transaction renders it suspicious. Various red flags were noted:

- The owner of the Maltese entity is a management consultant and holds no previous experience in this trading activity;
- Upon incorporation, the Maltese entity immediately entered into a significantly large transaction;
- No technical due diligence on the equipment was carried out prior to the acquisition by the Maltese entity;
- The lack of correspondence with the supplier and due diligence undertaken may be indicative that the Maltese entity is acting on behalf of someone else;
- The bank account held by the Maltese entity is with a Romanian bank;
- The German supplier uses the same correspondence address and legal advisors as the customer located in Turkey. This connection raises concerns that the transaction is not at arm's length;
- The purchase and sales agreement are drawn up on back-to-back terms. The expected financial safeguards against credit risk are not in place;
- The late changes to the payment arrangements for both the purchase and sale of the equipment are made without sufficient reason and justification.

The implementation of an effective anti-money laundering compliance programme requires subject persons to understand the intricacies of TBML schemes and their red-flag indicators. Customer due diligence must extend beyond identification and verification. Subject persons are expected to understand their customers' business, which includes building a customer profile. Monitoring actual activity against the customer profile should be carried out throughout the business relationship. The exercise of professional scepticism will render the due diligence and monitoring efforts more meaningful and effective.

(*) The case study is based on a real case in Malta. Changes were made to the products, places and sequence of events to preserve confidentiality.



Alan Craig is the advisory partner at Mazars in Malta, specialising in internal audit, governance, money laundering and regulatory compliance.



Rebekah Barthet is a forensic investigation and compliance senior manager at Mazars in Malta, specialising in investigation assignments and regulatory compliance.