Australian Government
Australian Institute of Criminology

Trade-based money laundering: Risks and regulatory responses

Clare Sullivan
Evan Smith

AIC Reports
Research and Public Policy Series 115

Trade-based money laundering: Risks and regulatory responses

Clare Sullivan
Evan Smith

AIC Reports
Research and
Public Policy Series
115

www.aic.gov.au

ISSN 1836-2060 (Print)
1836-2079 (Online)
ISBN 978 1 921532 96 2 (Print)
978 1 921532 97 9 (Online)

Project no. 0140

Published by the Australian Institute of Criminology
GPO Box 2944
Canberra ACT 2601
Tel: (02) 6260 9200
Fax: (02) 6260 9299
Email: front.desk@aic.gov.au
Website: http://www.aic.gov.au

Please note: minor revisions are occasionally made to publications after release. The online versions available on the AIC website will always include any revisions.

Disclaimer: This research report does not necessarily reflect the policy position of the Australian Government.

General editor, Research and Public Policy Series :
Dr Adam M Tomison, Director, Australian Institute of Criminology

Note: Research and Public Policy Series publications are peer reviewed

Edited and typeset by the Australian Institute of Criminology

A full list of publications in the AIC Reports series can be found on the Australian Institute of Criminology website at **http://www.aic.gov.au**

Foreword

This report examines a form of money laundering based on the trade of goods and services, commonly known as trade-based money laundering (TBML), and the characteristics of this particular criminal activity. Misuse of trade operations has been identified as an emerging form of money laundering that needs to be addressed by several anti-money laundering and counter-terrorism financing (AML/CTF) agencies around the world, including the Financial Action Task Force (FATF), Europol and the Bureau of International Narcotics and Law Enforcement Affairs, as well as, in Australia, the Australian Transaction Reports and Analysis Centre and the Australian Crime Commission. While TBML has been signalled as a concern by these agencies, this type of money laundering is not well understood—in terms of its procedures, as well as its prevalence in Australia and overseas. The purpose of this report is to provide enhanced understanding of TBML through the following—attempting to define clearly what constitutes TBML, identifying the risks of TBML in Australia and around the world, analysing what strategies and programs have been devised to tackle TBML globally, and exploring the possibilities for combating TBML in Australia.

The most common types of TBML involve trade description fraud. However, TBML can also take other forms including the concealed transportation of cash using trading operations, which is different from cash smuggling by individuals (cash couriers); the acquisition and sale of intangibles, such as the sale of PINs; and related party transactions, where one business or corporate group operates both the import and export ends of a trade transaction, thus permitting fraudulent trading to occur, including the potential for TBML. It is acknowledged that TBML often overlaps, or is used in connection with, other forms of money laundering using the financial system, but it is important to be aware that it exists and can often go undetected under current AML/CTF regulatory activities.

Australia's strict border and customs regulations do, however, limit the opportunity for TBML to occur to some degree. This report highlights that one of the risk factors for TBML is the existence of open borders for trade purposes (or lax border controls in general). There is a high risk of TBML associated with trade within Free Trade Zones, such as the open border arrangements of the European Union. Australia's lack of Free Trade Zones (despite being part of several Free Trade Agreements) is likely to contribute to a somewhat lower risk of TBML.

This report has found that the global response to TBML has been limited so far. This is partly due to the fact that not enough is known about TBML, limiting the ability of many countries to implement any kind of regulatory framework to address the problem, but also partly because combating TBML would require the implementation of different mechanisms than are currently used to combat money laundering within financial systems. FATF's recommendations for combating TBML are far narrower than the 40+9 Recommendations outlined for dealing with money laundering and financing of terrorism generally, with much more emphasis being placed on education and raising awareness, as well as information gathering and dissemination among relevant agencies. Australia's current *Anti Money Laundering/Counter Terrorism Financing Act 2006* (Cth) is directed towards detecting money laundering and terrorism financing within the financial system by making it compulsory for nominated reporting entities to report suspicious activities. There is a concern that the introduction of a requirement to compel traders to undergo the same level of regulation would be very costly and very difficult logistically. Further, given the Australian

Government's emphasis on maintaining low levels of compliance burden on business, it is unlikely that general implementation of the regime to trading entities would be viable.

The narrower recommendations set out by FATF are much more in line with what Australian authorities are inclined to do in response to risks of TBML. Enhancing education and awareness-raising concerning TBML by FATF corresponds with AUSTRAC's policy of educating people, businesses and agencies about AML/CTF generally, and consideration might be given to incorporating more information about TBML specifically, into current education and training. FATFs proposals to disseminate information, share intelligence more widely and develop new databases, units and taskforces to analyse data, may provide an enhanced response to TBML, although arguably, more research needs to be conducted into the nature and impact of TBML before such avenues for reform are pursued in Australia.

Adam Tomison
Director

Contents

Tables

Acknowledgements

The authors are grateful to the many individuals who agreed to participate in consultations with Clare Sullivan in Australia and overseas, and to the agency staff in Australia and the external referees who provided helpful feedback on earlier drafts. These included experts from Australian and overseas law enforcement, prosecution and regulatory agencies. Appreciation is also extended to Dr Russell G Smith, Principal Criminologist at the AIC, for his advice throughout this study and to AIC Senior Research Analyst, Dr Samantha Bricknell and former Senior Research Analyst, Dr Kim-Kwang Raymond Choo, for assisting in the preparation of this publication.

Acronyms

ACBPS	Australian Customs and Border Protection Service
AML/CTF	Anti-money laundering/counter-terrorism financing
AML/CTF Act	*Anti Money Laundering/Counter Terrorism Financing Act 2006* (Cth)
AUSTRAC	Australian Transaction Reports and Analysis Centre
BINLEA	Bureau of International Narcotics and Law Enforcement Affairs
DARTTS	Data Analysis and Research for Trade Transparency Systems
DNFBPs	designated non-financial businesses and professions
FATF	Financial Action Task Force
FinCEN	US Department of Treasury, Financial Crimes Enforcement Network
FTAs	Free Trade Agreements
FTZs	Free Trade Zones
NCCT	non-cooperative countries and territories
PINs	personal identification numbers
TBML	trade-based money laundering
TBML/TF	trade-based money laundering/terrorist financing
TTU	Trade Transparency Units
US ICE	United States Immigration and Customs Enforcement

Executive summary

This report examines the use of trade, principally international trade, to launder the proceeds of crime and the effect that trade-based money laundering (TBML) has on Australian interests. The aim was to assess the nature, extent and ramifications of TBML globally and the possible risks for money laundering in Australia.

This research is based on an assessment of a range of publicly available resources from Australian and international government agencies, the private sector and academic research. This was supplemented by background information provided by Australian and international stakeholders and experts.

Trade-based money laundering techniques and defining features

TBML is known to be used to disguise proceeds of crime and to mask legitimately obtained funds that are directed towards terrorism and other criminal activity. TBML techniques range from simple fraud, such as the misrepresentation of prices, quantity or quality of goods on an invoice, through to complex networks of trade and financial transactions. While TBML schemes most commonly involve the misrepresentation of price, quantity or the type of merchandise, trade in intangibles (such as information and services) is emerging as a significant new TBML frontier—also known as *service-based money laundering* (see Lormel 2009). TBML (and the approaches designed to address it) is defined in terms of international trade, rather than domestic trade.

There is a fine line between TBML and other money laundering methods and in practice, they often overlap. Many TBML schemes use financial transactions to launder funds. TBML may also result in evasion of income tax and excise and involve other financial crimes, although tax evasion may not be the primary objective. For clarity of analysis and to assist understanding of TBML and its ramifications, TBML is defined and differentiated from other types of money laundering and associated activities such as tax evasion.

Bearing in mind the essential features of TBML, TBML is defined here (and developed within the report) as *the use of trade to move value with the intent of obscuring the true origin of funds*. TBML does not include transportation of cash and bearer negotiable instruments, nor does it include the services provided by alternative remittance dealers.

Several factors make trade attractive to money launderers. These include growth in volume and value of world trade and the relative ease of disguising the true nature of the trade, especially by comparison with other money laundering avenues, which are subject to closer scrutiny. There is anecdotal evidence that increased reporting and scrutiny of financial transactions, as a result of anti-money laundering/counter terrorism financing (AML/CTF) initiatives, is making trade more attractive as a vehicle for money laundering (FATF 2006). The concern is that, unless TBML is addressed, it will increase and become entrenched.

While TBML methods such as over- and under-invoicing and merchandise substitution are not new, there is a growing awareness of TBML among governments, experts, business and individuals.

The full extent of TBML as it affects Australia and its interests is currently unknown. This is of concern, given the ramifications of TBML. However, TBML is arguably a significant concern for a country like Australia that relies heavily on trade and foreign

investment, although it is likely that TBML poses a more significant risk in regions where border security is not as restrictive, such as Free Trade Zones (FTZs) or the European Union.

Future Australian and international anti-trade based money laundering strategies

There has been little research conducted internationally and within Australia on TBML. With the Australian Government's emphasis on evidence-based policy and regulatory development, there is a need for further research to be undertaken in this space to address existing gaps in knowledge concerning the nature and extent of TBML and how to design national regulatory measures to address them most effectively.

In collaboration with the respective trade bodies and subject matter experts, the Australian Government could, arguably, take a leading role in capacity-building and awareness-raising, both within government agencies and with existing reporting entities who facilitate trade through the provision of financial or logistical services (eg financial institutions) in Australia and with Australia's trading partners. These agencies and service providers would benefit from a better understanding of TBML within the Australian context.

This report argues that the formation of a regulatory framework to deal with TBML would be premature and unnecessary at this stage, as more research needs to be conducted to ascertain with greater precision the nature, risks and prevalence of TBML in Australia.

Introduction

The primary aims of those who commit economic crimes are to secure a financial advantage and to be able to make use of the stolen funds without being detected by police or regulatory agencies. Many criminals seek to disguise the origins of their criminally derived funds by engaging in money laundering to enable them to materially benefit from their crimes and avoid detection by the authorities. Organised criminals, in particular, see many benefits to money laundering, which include the ability to enhance their lifestyle and to enable the profits of their crimes to be reinvested in future criminal activities or in legitimate business operations.

In response to mounting international concern about money laundering, the Financial Action Task Force (FATF) on money laundering was established in 1989. The FATF is an inter-governmental body that sets international standards and develops and promotes policies to combat money laundering and terrorist financing.

In a 2006 report, FATF identified the use of international trade as an emerging avenue for money laundering, particularly as the financial sector became more regulated in an attempt to stop money laundering and the financing of terrorism. One of FATF's key research findings in that report is that

> [t]rade-based money laundering is an important channel of criminal activity and, given the growth in world trade, it represents an increasingly important money laundering and terrorist financing vulnerability (FATF 2006: 25).

For the purpose of this report, TBML is defined as *a form of money laundering that uses trading operations to conceal the origins of (often illegally obtained) funds*. This is usually done by trade-description fraud, such as the over- and under-invoicing of goods, over- and under-shipment of goods, multiple invoicing or falsely describing goods, although TBML can also entail fraudulent acquisition and sale of intangibles (such as consultancies and similar services or PINs), or related-party transactions.

Aim of report

This study forms part of a four year research project undertaken by the Australian Institute of Criminology examining a number of aspects of Australia's AML/CTF regime. The research presented in this report considers a form of money laundering using trade operations, commonly known as TBML, and explores the characteristics of this particular criminal activity. TBML has been identified as an emerging form of money laundering that needs to be addressed by several AML/CTF agencies around the world, including FATF, Europol and the Bureau of International

Narcotics and Law Enforcement Affairs (BINLEA). In Australia, there have been similar warnings from the Australian Transaction Reports and Analysis Centre (AUSTRAC) and the Australian Crime Commission. While TBML has been signalled as a concern by these agencies, this type of money laundering is not well understood in terms of its nature and its prevalence in Australia and overseas. The purpose of this report is to develop a greater understanding of TBML by:

- defining what constitutes TBML;
- identifying the risks of TBML in Australia and around the world;
- analysing what strategies and programs have been devised to tackle TBML globally; and
- exploring the possibilities for combating TBML in Australia.

Methods

Research comprised a review of publicly available official reports and literature on TBML from a range of Australian and international sources. While the latest publicly available information has been used, there are time delays, especially in the release of official statistics, which make it difficult to present completely contemporary information. At present, the information about TBML and its impact is relatively limited. Unlike money laundering using the financial system, TBML is an emerging concept that has had little attention from academic scholars and regulatory and policy bodies. Thus, it is often the case that currently available information does not provide accurate definitions of TBML, or explain how it differs from other forms of money laundering.

This review of the publicly available literature was guided by consultations with experts and stakeholders from Australian and overseas law enforcement, prosecution and regulatory agencies who were identified as having operational information and experience of direct relevance to TBML and its impact on Australian interests. These consultations have formed the background to the research contained within this report, although all material reported on here is taken from publicly available sources.

Limitations

As with many studies of complex financial crime, the present report is subject to a number of limitations. First, the data used in this report could only be sourced from publicly available information. Second, TBML is not clearly defined nor understood, which means that instances of TBML activity may not be recognised as such and therefore may not be distinguished from other forms of money laundering and terrorism financing. Third, and perhaps partly as a result of the first two limitations, the number of case studies this report describes is quite small. Finally, most of the instances of TBML identified in this report come from overseas, particularly the United States, but also from FATF, the Asia/Pacific group on Money Laundering and the Eurasian Group on Combating Money Laundering and Terrorism Financing. Little is publicly known about the nature and extent of TBML in Australia.

Report structure

Following the *Introduction*, the report seeks to define TBML more clearly as a distinct form of money laundering that can be identified separately from other forms of money laundering involving financial systems. This section also looks at the risk environment in Australia and around the world that may allow TBML to occur.

The following section explores how agencies outside of Australia have responded to TBML, how FATF have devised recommendations that specifically relate to TBML and that are narrower in scope than the 40+9 Recommendations made to combat money laundering and terrorism financing more widely. This section also examines the Trade Transparency Units (TTUs) established by the US Immigration and Customs Enforcement (US ICE) as an example of how countries may choose to practically deal with TBML.

Consideration is then given as to how TBML may be dealt with by Australian authorities. Assessment is made of how the current AML/CTF regime could be applied to those dealing with financial systems and the limitations that would impact on transferring this program to those dealing in trade transactions.

FATF's Best Practices Paper on TBML, with its emphasis on education and awareness training, is taken as a framework for Australia's initial ventures into combating TBML. In essence, it is concluded that while TBML has been highlighted as an emerging concern by AML/CTF agencies in Australia and elsewhere around the globe, more research needs to be done to delineate how TBML operates and the extent to which it occurs, globally and in Australia.

The nature of trade-based money laundering

TBML has, for the most part, not been adequately defined and, as a consequence, its nature and its extent are not well understood. Baker (2005: 25) has argued that because '[a]nything that can be priced can be mispriced' and '[f]alse pricing is done every day, in every country, on a large percentage of import and export transactions' that TBML 'is the most commonly used technique for generating and transferring dirty money—money that breaks laws in its origin, movement and use'. However, from the publicly available material, the extent of TBML is unknown. FATF (2006: 3) observed in its June 2006 report *Trade-based Money Laundering* that TBML 'has received considerably less attention in academic circles than other means of transferring value'. As a result, TBML is currently a rather nebulous activity. However, there is a concern that TBML is becoming a more prevalent threat, with the Australian Crime Commission's (2011: 48) recent report on organised crime in Australia stating that '[t]rade-based money laundering and bulk cash smuggling are international concerns that have been identified as emerging or possible threats in Australia'.

Academic literature and many official reports generally do not clearly define TBML. This is partly due to the fact that TBML can take many forms and the boundaries between TBML and money laundering using the financial system are often blurred. For analysis, the two categories of money laundering (trade and finance) need to be more clearly distinguished.

In this section, the essential features of TBML are distilled in an attempt to define TBML and distinguish it from other forms of money laundering. Selected sanitised TBML case studies and known methodologies are used for this analysis. In addition to categorising the basic techniques used for TBML, this section also examines the use of financial information as an indicator of potential TBML and areas of significant TBML vulnerability.

Defining and distinguishing trade-based money laundering

FATF (2006: 3) defined TBML as 'the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origin'. By contrast, the FATF (2008a: 1) *Best Practices Paper* on TBML, defined TBML as:

> the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins or finance their activities.

The former definition is more limited in that it deals only with the obscuring of the origin of funds whereas the latter includes the use of the funds for the financing of activities.

The two FATF definitions capture the essence of money laundering, which is the movement of value. For that reason, they are preferred to the definition used in the BINLEA's (2004: 21) *International Narcotics Control Strategy Report* which is 'the use of trade to legitimize, conceal, transfer, and convert large quantities of illicit cash into less conspicuous assets or commodities'. The FATF definitions are also broader than the definition of TBML used by US ICE, which states that '[t]rade-based money laundering is an alternative remittance system that allows illegal organizations the opportunity to earn, move and store proceeds disguised as legitimate trade' (US ICE nd). This definition is even more limited in that it confines money laundering to an illegal organisation, when it is the illegal activity of an entity that earns and transfers funds that is the real concern. Furthermore, while the storing of funds, either obtained from crime or earmarked for criminal activity, is not particularly desirable, it is less crucial than how those funds are used in practice. Use requires movement of funds through electronic transfer, cheque or physical movement by cash courier for example. Alternatively, movement can be achieved by converting funds into other forms, such as goods and services. While this part of the US ICE definition seems to be directed to conversion of funds, such as assets for example, expressing this in terms of storing proceeds rather than movement of value, limits the accuracy and usefulness of the definition.

Neither FATF definition, however, sufficiently delineates a trade transaction from trade. Use of funds to purchase an asset like real estate can, in a broad sense, be regarded as a trade transaction because money is exchanged; that is, in that sense traded for land, but such an acquisition is not usually considered trade as such and not international trade. Further, a definition based on terms referring to the proceeds of crime excludes TBML involving otherwise legitimate sources of funds but which are intended for illegal activities, such as terrorism financing. Although this broader concept of TBML may not be the primary focus now, it may become a focus in the future. A more accurate and comprehensive definition of TBML, which captures its essential nature, is therefore needed to cover all forms of TBML.

For these reasons, TBML at its broadest and most basic is defined here as *the use of trade to move value with the intent of obscuring the true origin of funds.*

Trade includes both legitimate and illicit trade in goods and services. This definition adopts the basic approach used by FATF. Like the FATF definitions, the definition of TBML proposed here is framed in terms of movement of value. Movement of value is a defining feature of money laundering. In using 'trade' rather than 'trade transactions', potential overlap with areas covered by the first tranche of AML/CTF reforms is avoided.

Excluded from the definition is reference to the use of trade to avoid tax. There is a fine line between money laundering and tax fraud, which in its widest sense, includes fraud designed to avoid excise duties and income tax. One of the added features of many money laundering schemes is that they also avoid tax and excise. Essentially, the difference between money laundering and tax fraud is the primary objective of the activity. TBML differs from trade-based tax fraud as it is used not just to avoid paying taxes or excise on traded goods, but to use trading operations to move funds clandestinely and obscure the origins of these funds.

Defining a trader

In its *Best Practices Paper*, FATF (2008a: 2) defined a 'trader' as:

> anyone who facilitates the exchange of goods and related services across national borders, international boundaries or territories. This would also include a corporation or other business unit organized and operated principally for the purpose of importing or exporting goods and services (eg import/export companies).

However, there are two important caveats to this definition. The first caveat is that this definition only includes the key players in the international goods trade (ie exporters, importers and freight transporters) while domestic trade is not considered. Nonetheless, it is reasonable to assume that if international trade

is subjected to increased control and scrutiny, money launderers will look to opportunities presented by domestic trade. Money laundering using domestic trade presents much more challenging issues than international trade, as it doesn't have the established infrastructure to monitor local or interstate trade transactions. In countries like Australia and the United States, the Constitutional protection given to states' rights and to freedom of interstate trade, presents additional challenges. The unrestricted nature of domestic trade opens up a particular risk for TBML that would be difficult to detect.

The second caveat is that the FATF definition does not clearly extend to services, other than those 'related' to the trade of goods, although it would seem that FATF intended for the definition to cover trade in both goods and services. The case studies and typologies considered in this chapter show that services can also be used to launder money. It seems that the goods trade is more commonly used for TBML, but that may be because TBML using services is more difficult to detect. Moreover, it is reasonable to assume that as TBML schemes become more sophisticated, the use of services for money laundering will become more common.

Trade-based money laundering techniques

TBML techniques range from simple fraud, such as misrepresentation of the price, quantity or quality of goods on an invoice, through to complex networks of trade and financial transactions. Although TBML typically involves merchandise, it may also use trade in intangibles such as information, copyright and services—also known as service-based money laundering (Lormel 2009). Publicly available information on TBML in Australia is quite limited, but Box 1 refers to two publicly known cases of TBML in this country.

Trade description fraud

Trade description fraud is the most commonly described form of TBML and generally comprises one of the following techniques (FATF 2006).

Over- and under-invoicing of goods and services

As FATF (2006: 4) explains,

> [t]he key element of this technique is the misrepresentation of the price of the good or service in order to transfer additional value between the importer and exporter.

Invoicing the good or service at a price below the fair market price enables the exporter to transfer value to the importer. Similarly, invoicing at a price above market price enables the exporter to obtain a higher payment than the importer will receive on the open market.

The following example illustrates the types of inaccuracies which have been found:

> …[c]otton dishtowels imported from Pakistan into the U.S. for the…high price of $153.72 each, briefs and panties imported from Hungary for $739.25 a dozen, metal tweezers imported from Japan at $4,896 a unit, toilet bowls exported to Hong Kong for the ridiculously low price of $1.75 each, and missile and rocket launchers exported to Israel for a mere $52.03 each (BINLEA 2004: 21).

Multiple invoicing of goods and services

Unlike over- and under-invoicing, there is no need to misrepresent the price of the good or service on the commercial invoice. A complicated web of transactions is used whereby the same good or service is invoiced more than once, often using a number of different financial institutions to make the payments. Even if a case of multiple payments relating to the same shipment of goods or delivery of services is detected, the money launderers can explain the situation on the basis of amendment of payment terms, corrections to previous payment instructions or the payment of late fees, for example.

Over- and under-shipments of goods and services

By manipulating export and import prices, a money launderer can overstate or understate the quantity of goods being shipped or services being provided. There may be no actual supply of goods or services, only paperwork agreed by the importer and exporter. Financial institutions may unknowingly be involved in financing the phantom trade. An example of the

under-shipment of goods, published by FATF (2006: 10), is as follows:

- A criminal organisation exports a relatively small shipment of scrap metal, but falsely reports the shipment as weighing several hundred tons.
- Commercial invoices, bills of lading and other shipping documents are prepared to support the fraudulent transaction.
- When the cargo is loaded on board the ship, the customs officer notices that the hull of the ship is still well above the water line. This is inconsistent with the reported weight of the shipment of scrap metal.
- The cargo is examined and the discrepancy between the reported and actual weight of the shipment is detected.
- It is assumed that the inflated value of the invoice would have been used to transfer criminal funds.

Falsely described goods and services

The quality or type of good or service can be misrepresented. For example, a relatively inexpensive good is supplied but it is invoiced as being more expensive, of different quality or even as an entirely different item so the documentation does not accurately record what is actually supplied. This technique is particularly useful in TBML using services, such as financial advice, consulting services and market research, because, in practice, it can be difficult to determine the fair market value of these services (FATF 2006).

The Eurasian Group on Combating Money Laundering and Terrorism Financing's Working Group on Typologies (2009: 7) present an example of TBML by falsely describing goods in its 2009 report:

> A consignment of underwear, produced in Turkey, was exported from the country under fictitious documents with the aim of receiving a value-added tax refund. The goods sent abroad were, in fact, nothing more than shredded cloth. It was established that the company, the recipient of the goods, had been set up to create the illusion of international sales.

Other types of trade-based money laundering

There are other types of TBML that do not fit neatly into categories of trade description fraud, such as related party transactions and the acquisition and sale of intangibles.

Related party transactions

TBML requires collusion between traders at both ends of the import/export chain, but they do not

Box 1 Australian trade-based money laundering case studies

Case study 1: Paul Anthony Miller, a Managing Director of Eurovox Pty Ltd, was alleged to have conspired with Seigo Ito of Maruwa Electronic and Chemical Company to falsely invoice goods (such as tolling equipment, DVD players and television set-top boxes) and keep a portion of the money exchanged. This fits the TBML criteria of over-invoicing goods by misrepresenting the price of goods in order to transfer additional value between the importer and exporter. The charges against Miller included obtaining financial advantage by deception, money laundering, theft and falsifying documents. Originally sentenced to six years imprisonment (with a 4 year non-parole period), on appeal against his conviction and sentence he received an overall sentence of four years (with a 2.5 year non-parole period).

Source: *R v Miller* [2007] VSCA 249

Case study 2: Directors of a company were involved in purchasing large quantities of duty free cigarettes and alcohol to sell on the domestic market contrary to their export duty free status, thus avoiding tax obligations. The company generated false receipts [with] an export company detailing their alleged cigarette exports. Investigations confirmed that no such exports had ever been made. Payment was made for the cigarettes on a cash-on-delivery basis. A large number of the company's sales occurred over the internet from customers paying via credit card. A majority of the sales on the internet were illegitimate and came from three different email addresses. Payments for these orders were made from one of two credit cards linked to Belize bank accounts. One card was held in the company's name. The money in the Belize bank account was sent there by one of the directors using several false names from not only Australia but also Belize, Hong Kong and Vietnam. The director conducted structured wire transfers under false names and front company accounts. The funds were purchased at well-known banks with multiple transactions occurring on the same day at different bank locations and all of the cash transfers conducted in amounts of just under AUD10,000 to avoid the reporting threshold.

Source: APG 2008: 19

need to be linked (in the sense of ownership). Related party transactions (ie transactions between entities that are part of the same corporate or business group) can possibly make TBML easier to conduct and more difficult to detect as it is done 'in-house'. As FATF (2006: 5) pointed out, over- or under-invoicing of goods and services requires collusion between exporter and importer:

> [T]here is nothing that precludes a parent company from setting up a foreign affiliate in a jurisdiction with less rigorous money laundering controls and selling widgets to the affiliate at a 'fair market' price. In such a situation, the parent company could send its foreign affiliate a legitimate commercial invoice (e.g. an invoice of $2 million for 1 million widgets) and the affiliate could then resell (and 're-invoice') these goods at a significantly higher or lower price to a final purchaser. In this way, the company could shift the location of its over- or under invoicing to a foreign jurisdiction where such trading discrepancies might have less risk of being detected.

Differing tax rates and government incentives encourage international organisations to move funds and assets within the group.

Although there is a higher risk of related party transactions being used for fraud and for TBML, dealings between related parties are not necessarily illegal. Transfer pricing is a related party transaction that is commonly used by international organisations as part of the group financial and tax planning strategy. Multinational organisations use transfer pricing to shift taxable income from jurisdictions with relatively high tax rates to jurisdictions with relatively low tax rates to minimise income tax. Similar strategies are also employed in relation to import duties and value added tax, for example:

> a foreign parent could use internal 'transfer prices, to overstate the value of the goods and services that it provides to its foreign affiliate in order to shift taxable income from the operations of the affiliate in a high-tax jurisdiction to its operations in a low-tax jurisdiction. Similarly, the foreign affiliate might understate the value of the goods and services that it provides the domestic parent in order to shift taxable income from its high-tax jurisdiction to the low-tax jurisdiction of its parent (FATF 2006: 2–3).

FATF (2006: 3) made it clear though that

> [i]n the case of transfer pricing, the reference to over- and under-invoicing relates to the legitimate allocation of income between related parties, rather than customs fraud.

Related party transactions, including transfer pricing, rely on mutual agreement between the parties, rather than free market forces. Consequently, in Australia, related party transactions are subjected to close scrutiny especially by the Australian Tax Office.

Acquisition and sale of intangibles

To date, the focus of anti-TBML initiatives has primarily been on TBML using merchandise, but TBML using the services trade presents a much more significant challenge. Global trade in services provides greater opportunities for money laundering than trade in merchandise because fraud is more difficult to detect and prove. The intangible nature of services makes supply difficult to determine. Unlike merchandise, services are also less likely to be standard, so anomalies in value and price are less apparent and more difficult to substantiate. It is also common and lawful to include retainer and penalty payments which are payable even if the service is not actually supplied.

While trade description fraud covers most TBML, it is not used in all TBML schemes. Case Study 4 in the FATF (2006: 12) *Typologies Report* outlined a detected case of TBML using intangibles. This scheme involved the following steps:

- an alternative remittance system operator in the United States wants to transfer funds to his Bangladeshi counterpart to settle an outstanding account;
- the US operator deposits US dollars into his bank account and then wires the money to the corporate account of a large communications company to purchase telephone calling cards;
- the personal identification numbers (PINs) of these calling cards are sent to Bangladesh and sold for cash; and
- the cash is given to the Bangladeshi counterpart to settle the US operator's outstanding account.

This scheme uses trade, specifically the purchase of calling cards and the subsequent sale of PINs,

to avoid the scrutiny that would have been attracted by remitting the funds using the financial system. While there are (tangible) calling cards used in this case study, it highlights the sale of intangibles in TBML as the 'thing' that moves across borders. As the FATF (2006: 12) commentary on the case study explained:

> In this case, rather than simply wiring the funds to his Bangladeshi counterpart, the US operator chose to minimise the risk of detection through the use of the international trade system. Interestingly, the operator's scheme does not depend on fraudulently reporting the price or quantity of the goods in order to transfer the funds required to settle the outstanding account. In addition, the calling cards are not actually exported. All that is required is the cross-border transfer of the PINs (ie the sale of an 'intangible' good).

Trade-based money laundering risk environment

FATF has recently placed greater attention upon TBML. FATF (2006: i) considers that TBML is 'an increasingly important money laundering and terrorist financing vulnerability'. The features of trade make it highly attractive to money launderers. The chain of supply comprises many links, including transport, insurance and finance. More links provide more opportunity to launder money. International trade also involves different legal systems, different procedures and often different languages. These differences and discrepancies in communication and exchange of information between jurisdictions, compound to make international trade fertile ground for money laundering.

Nonetheless, '[i]nternational trade as a means of laundering money is...a technique generally ignored by most government law enforcement agencies' (Zdanowicz 2009: 855). Although there is increasing awareness of the use of trade for money laundering, it is only in the United States that there is a formal method of enforcement specifically for TBML, largely as a result of the work done by US ICE and BINLEA.

It is estimated by BINLEA that, globally, hundreds of billions of dollars are laundered through trade (BINLEA 2009). While the exact extent and impact of TBML is unknown, it is certainly likely that the dollar value of money laundered using trade is high, especially considering the volume and value of world trade. In 2008 for example, global merchandise exports amounted to US$15.7t (WTO 2009). However, global trade has been significantly affected by the Global Financial Crisis. According to DFAT (2010a: 4), the Global Financial Crisis 'saw global trade flows (in volume terms) fall by 12 per cent in 2009'.

Specific risks

There are several specific areas of risk that can be exploited to facilitate TBML—barter/contra transactions, shell and front companies, and FTZs and other high-risk jurisdictions.

Contra and barter transactions

The use of contra and barter transactions presents a much more difficult problem than cash transactions. Contra and barter transactions do not involve financial institutions and are not generally subject to scrutiny and reporting requirements in the present AML/CTF regime. Like cash, these types of transactions are appealing vehicles for TBML. BINLEA (2004: 21) reported that

> in some areas of the world, trade goods are bartered for other commodities of value. In regions of Pakistan and Afghanistan, illegal drugs are commonly thought of as a commodity or trade good. Law enforcement authorities have reported, for example, that the price for a kilogram of heroin in this region of the world is a color television set. There are other barter networks where narcotics in Pakistan and Afghanistan are exchanged for foodstuffs such as vegetable oils.

Shell and front companies

Both shell and front companies can be used to facilitate TBML but in different ways. A shell company has no real operating activities and is used to hide money laundering activity and the identities of individuals involved to obscure the money trail. If activity is traced to the company it is literally

an empty shell. As FATF (2010: 20) explained:

> TBML and other money laundering schemes rely on the ability of the perpetrator of the crime to distance themselves from the illicit proceeds. Shell companies enable illicit actors to create a network of legal entities around the world.

By contrast, a front company is a real business whose legitimate operations are used as a cover for money laundering and other criminal activity. In many ways, front companies present a much more significant TBML threat than shell companies. The UNODC (2007: 44) in its 2007 report *An Assessment of Transnational Organised Crime in Central Asia* explained how front companies are used for TBML in that region:

> One of the most important money-laundering techniques in Central Asia is the use of front companies. These companies provide ostensibly legitimate sources of income and opportunities for trade-related laundering through false invoicing. In order to open front companies, organized criminal groups in Kazakhstan have targeted banks, casinos and businesses engaged in food processing, distilling and export trade. Casinos are particularly useful for money-laundering and there is some concern about their exploitation in both Kyrgyzstan and Kazakhstan. According to the UNDP country profile for 2002, front companies have also been widely used in Kyrgyzstan, where it is believed that illicit revenues from trading in drugs and weapons and the smuggling of alcohol and tobacco are typically transferred to front companies.

In many jurisdictions, including Australia, it is relatively easy to form a company. This ease of incorporation is driven by a desire to facilitate legitimate business. There is little, if any, scrutiny given to the individuals seeking to form a company, nor its managers and shareholders. Non-existent or low capital requirements encourage the formation of shell companies and minimal corporate reporting requirements, combined with the ability for shares to be freely traded, further encourage abuse. As one commentator recently observed:

> In many places, an offshore corporation does not need to disclose the information of its shareholders, equity ratio, earnings and so on to the public. In such areas as the Cayman Islands, even the names of the shareholders can be kept as a secret...offshore companies can enjoy rather preferential local taxation policy. In a word, the characteristics of offshore companies, for example, convenient formation, free operation, tax exemption and financial secrecy, all provide rather good opportunities for tax evasion, capital flight and money laundering (He 2010: 26).

High-risk jurisdictions

A number of Australia's major trading partners present a high TBML risk due to the volume of trade, value of the trade, the type of commodity or service traded and/or the domestic regulatory environment. Often, all these factors combine to make a jurisdiction at high risk of TBML. The People's Republic of China, for example, presents a TBML risk on the basis of volume of trade alone. Other jurisdictions in the Asia–Pacific region are a high TBML risk because of the type of trade that passes through the border. Transhipment jurisdictions like Singapore (Australia's fifth largest provider of imports according to DFAT (2010b)) have a higher risk of TBML and trade fraud because transhipped consignments are not inspected. A report by BINLEA (2010) advised that Singapore needed to pay greater attention to TBML and strengthen its border security. Another one of Australia's key import providers, according to DFAT (2010b), is Japan, with the report by BINLEA (2010) also identifying the country as a potential TBML risk because of the presence of organised crime in Japan and its status as a major trading power.

Similar vulnerabilities have been identified for the US by the Financial Crimes Enforcement Network (FinCEN) from suspicious activity reports. FinCEN's (2010: 8) report, while specifically relating to US trade, indicated the risk of TBML in relation to trade with China:

> Transactions involving entities in Mexico and China were the most frequently named in SAR narratives reporting TBML activity. However, over the four year period from 2004 to 2008, TBML SAR narratives involving transactions in China continued to increase while narratives citing a connection to Mexico were beginning to decrease.

Free trade zones

FTZs are also emerging as being especially vulnerable to TBML. FATF (2010: 4) defines FTZs as 'designated areas within countries that offer a free trade environment with a minimum level of regulation'. FinCEN has identified TBML red flags that are specific to FTZs and FTZs were the subject of a recent money laundering report by FATF (FATF 2010; FinCEN 2010). Although Australia does not have any FTZs, they are of general concern to Australia and Australian interests because FTZs are part of the international trade network.

The number of FTZs has rapidly increased and there are now approximately 3,000 FTZs in 135 countries (FATF 2010). In 2007, total exports from FTZs were estimated at US$400b (FATF 2010). While FTZs have existed throughout the twentieth century, the globalisation of the world economy over the last few decades has seen an expansion in the number of FTZs. But FATF (2010: 3) has also observed that the liberalisation of trade barriers in the FTZs has made them 'highly attractive for illicit actors who take advantage of this relaxed oversight to launder the proceeds of crime and finance terrorism'.

In its report, FATF (2010: 16) noted that

> [m]ost zone authorities operate separate company formation services from those that exist in the rest of the jurisdiction and market the ease of setting up a legal entity in an FTZ to attract business. Many zone authorities request little or no ownership information of the companies interested in setting up in the zone. As a result, it is simpler for legal entities to set up FTZs and hide the name(s) of the true beneficial owners.

This lack of transparency has allowed companies located in FTZs to create layers of transactions that are difficult (if not impossible) for law enforcement agencies to follow (FATF 2010).

Significantly, FATF (2010: 16) reported that 'goods introduced in a FTZ are generally not subject to the usual customs controls, with goods undergoing 'various economic operations, such as transhipment, assembly, manufacturing, processing, warehousing, re-packaging and re-labelling as well as storage for timely marketing, delivery and transhipment'. In particular, FATF observed that 'repackaging in FTZs is one of the tools used by criminals to cut the links with the real country of origin or destination' (FATF 2010: 17).

FTZs also compound the money laundering risk of other practices, notably the use of cash. Cash and bearer negotiable instruments present particular money laundering/terrorist financing risks because of their portability and lack of an audit trail. As FATF (2010: 15) pointed out, cash is also easy to use in trade transactions in FTZ—'integration of cash into a jurisdiction's financial system is often facilitated by the presence of financial institutions in the zones'. FATF (2010: 15) further reported that

> [even] if banks outside of the FTZs are involved in the trade transactions, they are less able to manage [money laundering/terrorism financing] risks because of the other vulnerabilities of the zones (opaqueness and relaxed oversight).

In its 2010 report, FinCEN (2010: 4) signalled that a number of

> red flags seen in conjunction with shipments of high dollar merchandise (such as electronics, auto parts and precious metals and gems) to duty free trade zones, such as in the Colon Free Trade Zone in Panama, could be an indication of a trade-based money laundering activity.

These include:

- third-party payments for goods or services made by an intermediary (either an individual or an entity) apparently unrelated to the seller or purchaser of goods. This may be done to obscure the true origin of the funds;
- amended letters of credit without reasonable justification;
- a customer's inability to produce appropriate documentation (ie invoices) to support a requested transaction; and
- significant discrepancies between the descriptions of the goods on the transport document (ie bill of lading), the invoice, or other documents (ie certificate of origin, packing list etc) (FinCEN 2010).

FTZs should be clearly distinguished from Free Trade Agreements (FTAs). While Australia does not currently have any FTZs, it does have FTAs including the agreement establishing the Australia–New Zealand Free Trade Area and FTAs with New Zealand, Chile, Singapore, Thailand and the

United States. Australia is also negotiating FTAs with China, Japan, Malaysia, the Republic of Korea, the Gulf Cooperation Council and the Trans Pacific Partnership (DFAT 2010a). The primary purpose of an FTA is to increase competition by reducing or removing barriers to trade, particularly tariffs. FTAs also address restrictions, such as quotas and other measures, taken by countries to protect their domestic markets from foreign competition. However, goods from countries that have FTAs with Australia are still subject to inspection. This means that the TBML risk for Australia is lower than for countries in FTZs, with an economic benefit from the FTA, but the physical cargo still being scrutinised under Australia's customs and border protection guidelines.

Difficulties associated with evaluating trade-based money laundering risks

Information is the foundation of an effective AML/CTF strategy. With current AML/CTF programs, information provided by law enforcement agencies, international research and typologies and financial intelligence units (such as AUSTRAC) forms the basis of much of the analysis of money laundering in all its forms, which can include TBML. Information influences the design and implementation of the money laundering programs and the programs' effectiveness in addressing money laundering. Consequently, the type and quality of information provided by reporting entities influences the accuracy of money laundering analysis. Analysis is used to tailor national and international programs and to fine-tune management of money laundering risk at reporting entity level, as well as for any intelligence unit in monitoring and investigating money laundering activity. However, there are several factors, as described below, which pose difficulties for gathering and analysing information about TBML.

Limited case study knowledge

There is concern about the relevance of the some of the information which is collected under the present AML/CTF schemes. As Geary (2009: 218) wrote:

> It has been suggested that up-to-date, relevant ML information is not readily and promptly available to entities under the present AML/CTF regime...something more by way of information is needed to design useful controls to avoid the two evils of either being a merely compliant AML/CTF program or, alternatively, a business-stopping AML/CTF program. And this information needs to be current information about [money laundering]—its extent and mode within the business sector of the regulated entity as it is occurring in real time, in all of its chaos and randomness.

FATF (2008b: 5), in its 2008 report entitled *Money Laundering & Terrorist Financing Risk Strategies* concluded that

> the best risk assessment methodology uses a combination of approaches in order to capture all that is known and as much as possible about what is not known.

The report specifically referred to retrospective risk assessments, namely, risk assessments that draw on data from the past to help anticipate future problems, as well as prospective risk assessments that anticipate future developments. For the most part, however, money laundering risk is assessed on the basis of retrospective information, particularly known case studies and typologies, rather than anticipated, hypothetical scenarios. Information about money laundering methods and schemes is generally made available to regulated entities in the form of sanitised cases and typologies, which are disseminated primarily through business/industry conferences and seminars.

The use of sanitised typologies and sanitised case studies is driven by confidentiality and privacy obligations, and concerns by regulatory authorities not to tip off criminals that their operations are being scrutinised. These are legitimate concerns and precautions are clearly necessary. However, as a consequence, the information available to reporting entities, which influences their risk assessment, is often not current, nor is it sufficiently specific to the business of the recipient reporting entities. Potentially, this reduces the effectiveness of the design and implementation of an entity's risk-based program. Ultimately, it impacts on the overall effectiveness of the national and international AML/CTF regime.

Economic profiling and statistical modelling

As is the case for reporting entities, typologies and case studies also provide limited information to TBML intelligence units. Typologies and case studies tell investigators how and where money laundering takes place and may also provide information about the identity of the money launderer and their motive and objective. However, even detailed information about a particular case or typology can provide only limited information about money laundering and TBML from a macro perspective.

While typologies and case studies add to an understanding about the behaviour of money launderers, it is unclear to what extent specific case information is representative of TBML activity. What percent of total money laundering cases do the known cases and typologies account for? Are the known features of TBML still current and most importantly, are those known features typical or atypical?

While these questions may never be definitively known, economic and statistical modelling has attempted to answer these questions. Economic profiling has also attempted to predict the likely development of TBML. The use of statistical modelling and economic profiling as descriptive and predictive tools for money laundering (particularly for TBML) is currently an under-researched but emerging research area, which requires further development. It should be acknowledged, however, as is the case for case studies and typologies, statistical modelling and economic profiling have their own set of limitations.

By way of background, Unger (2009: 808) pointed out:

> [i]n academia, money laundering is still an unexplored field, in particular in economics. So far, the economics of crime has not devoted much attention to financial crime. And the economics of finance has not dealt with criminal behavior. Cooperation with other disciplines such as law, criminology and anthropology, and with international organizations and practitioners of crime enforcement remains almost absent in this area.

Nevertheless, there are three new methods to estimate the amount of money laundering globally, which Unger (2009: 812) has described as 'promising'. The three recent methods are the gravity model (Walker & Unger 2009), statistical analysis of unusual trade data (Zdanowicz 2009); and the dynamic equilibrium model (Bagella, Busato & Argentiero 2009).

The Walker and Unger (2009) gravity model is based on international trade theory. According to Walker and Unger (2009: 821), if the scale of money laundering is known, this model can be used to calculate 'its macroeconomic effects and the impact of crime prevention, regulation and law enforcement effects on money laundering and transnational crime can also be measured'. However, this relies upon the scale of money laundering being known, which it is not.

Zdanowicz (2009) used economic analysis of US trade data, produced by the US Commerce Department of the Census Bureau, to identify suspicious trading countries and suspicious trade. The data were used to develop indices for TBML risk, based on country and on the item traded, according to both weight and price, and hence to identify the country and trade that sat outside normal parameters. Zdanowicz's (2009) method assumed that prices and weights were normally distributed and that unusual prices (which may be legitimate) indicated money laundering. However, Unger (2009: 813) noted that a 'still-unresolved weakness of the model' was that 10 percent of all transactions consistently came out as suspicious, irrespective of price fluctuations.

The third model uses economic theory to determine how a rational money launderer will act. This theoretical model was developed by economists Bagella, Busato and Argentiero (2009) to estimate money laundering in Italy. They have since applied the model to the United States and to the EU-15 countries. The model forecasts the development of the legal and the illegal sectors of the economy.

The model's legal sector can be compared to the development of the actual gross domestic product of a country, so the accuracy of the model in predicting the observable part of the economy can be assessed. The theoretical finding for the illegal sector indicates the extent of money laundering. This model is considered promising in predicting rational money laundering behaviour but it relies on liquidity

as a predictor and does not take interest rates into account. Its usefulness is therefore currently limited, especially as a predictor of money laundering emanating from Australia, although it may provide an indication of the growth of the illegal economy in countries which trade with Australia.

McSkimming (2010) has noted, using Unger's work among others, that statistical modelling on money laundering, particularly TBML, is based on several assumptions and is limited in what it can tell us about TBML patterns and frequency. This also affects how countries prepare for dealing with TBML. As McSkimming (2010: 57) wrote:

> There is little reliable data on the volume of capital that is laundered...which of course, makes estimating its effects almost impossible, Within this context, it is not possible to convincingly demonstrate the effects of money laundering generally, let alone the particular effect of [trade-based money laundering/terrorism financing] TBML/TF. This, in turn, makes responding proportionally to the TBML/TF threat very difficult.

This discussion has sought to clearly define TBML and to distinguish it from other forms of money laundering, while acknowledging that in practice, these forms of money laundering may overlap or both may be employed at once. TBML often involves a complex series of transactions and operations to ensure that the value of what is being traded is concealed or obfuscated; thus, a clearer understanding of TBML and its associated typologies is helpful for those who seek to combat the crime.

Risks of TBML arise from several sources. First there is the barter trade, where goods are traded instead of money (which makes the origin and flow of these goods difficult to trace) and can be used for laundering and terrorism financing. Second, there is the use of shell and front companies that can be used to make fraudulent imports and exports. Third, TBML operates most effectively where there is a limited chance of the goods being inspected and placed under scrutiny. For these reasons, FTZs and places where there are lax borders provide opportunities for TBML that can be exploited.

This understanding of TBML is primarily sourced from a combination of publicly available case studies and statistical modelling, and some of the limitations that researchers and other interested parties come across in trying to determine occurrences of TBML have been highlighted. These include a lack of publicly accessible material on TBML typologies and awareness of TBML as a distinct form of money laundering. It is evident from the available literature than there needs to be an emphasis on further research on TBML typologies and risks across the globe. Specifically, there would appear to be a need for a more fine grained approach to researching TBML, which focuses on identifying the key features of a trading relationship that facilitates this form of money laundering and that identifies the vulnerabilities in the TBML system that might be exploited by law enforcement agencies.

Responses to trade-based money laundering

Over the last decade, there have been significant initiatives across the globe to combat money laundering and the financing of terrorism. The US Government and the European Union have both developed widespread AML/CTF programs and through transnational agencies, such as FATF, there has been a push to establish coordinated and interconnected AML/CTF strategies, with an emphasis upon compliance with FATF's 40+9 Recommendations (although the level of compliance by individual countries is varied). Although how successful the global AML/CTF response has been is not conclusive, its possible effectiveness in limiting certain avenues of money laundering, primarily using financial systems to launder money and finance terrorist activities has been attributed to the apparent rise in TBML.

Global anti-money laundering/counter-terrorism financing programs

FATF first issued its 40 Recommendations on anti-money laundering in 1990.They were revised in 1996 and again in 2003, and are currently under review by FATF with an expected response to public consultations to be delivered at the Plenary Meeting in February 2012 (FATF 2011). In October 2003, FATF added 8 Special Recommendations on Terrorist Financing in the aftermath of the events of 11 September 2001. A recommendation addressing cash couriers was subsequently added in October 2004, making 9 Special Recommendations. Consistent with the OECD approach of ongoing consultation and enforcement through peer pressure, the 40+9 Recommendations rely on information gathering, mutual monitoring and 'name and shame' sanctions (Levi & Reuter 2006; Marcussen 2004). Recommendations 21 and 22 of the 40 Recommendations set out sanctions that range from letters of warning to diplomatic missions to calls to other FATF members to take action. This approach has prompted one commentator to describe the FATF sanctions as 'a graduated system of embarrassment through peer pressure' (Simmons 2000: 255–258).

The 40+9 Recommendations apply to both state and non-state actors, such as financial institutions and designated non-financial businesses and professions (DNFBPs). Those DNFBPs cover five categories—lawyers, notaries and accountants when engaged in commercial transactions for clients, dealers in precious metals and precious stones, gambling casinos, real estate agents and company and trust service providers when engaged in a range of services (FATF 2004).

The 40+9 Recommendations call upon countries to:

- criminalise and penalise money laundering and the financing of terrorism;
- require customer due diligence and record keeping by financial institutions and DNFBPs;
- require the reporting of suspicious transactions and other similar measures;
- provide for sanctions against non-compliant states;
- create and maintain competent authorities to prevent money laundering, including law enforcement;
- supervise financial institutions and DNFBP; and
- engage in greater international cooperation.

AML/CTF frameworks are founded on cooperation and standards of conduct to address common issues of concern. This is true of the program at international level as well as its domestic implementation. In Australia, the *Anti Money Laundering/Counter Terrorism Financing Act 2006* (Cth) (AML/CTF Act) sets out explicit sanctions and enforcement mechanisms.

This approach is especially effective where there is a clear need to generate standards to address mutual concerns and has been increasingly employed in international banking and more recently, in international finance (Malloy 2005). While increased regulation is generally regarded as unwelcome and often unwarranted, this type of compliance program provides incentive and encourages increased involvement, especially in an area where the private sector predominates (Wirth 2000). The program has been described as increasing 'opportunities to engage in desirable behavior' (Shelton 2000: 15). In the banking and finance sector, for example, it has been observed that those entities that do not adhere to the international standards set and monitored by the Bank for International Settlements:

> risk being regarded by major international banks and their financial authorities, including [the Bank for International Settlements] itself, as 'unattractive' business partners. And in this global economy they cannot afford to develop activities in isolation (Felsenfeld & Bilali 2004: 991–992).

These observations have been borne out in the implementation of the 40+9 Recommendations. By 2000, all except one FATF member had endeavoured to facilitate mutual legal assistance for investigations. All except two FATF members had established requirements for specific AML programs, including activity reporting; and most FATF members had enacted measures for customer identification. In 2000, FATF began identifying countries that had not implemented the 40 Recommendations by publishing a list of non-cooperative countries and territories (NCCT). The initial NCCT list contained 15 jurisdictions. By 2006, all of those 15 jurisdictions had made the necessary improvements to enable their removal from the NCCT list.

Periodic mutual evaluation of the implementation of 40+9 Recommendations by FATF members is a key component of global AML/CTF strategies. The evaluation reports are circulated to all FATF members and executive summaries are published in the FATF annual report.

However, there are limits to FATF's 40+9 Recommendations in regards to action on TBML. A working paper drafted by the UN Secretariat for the Twelfth UN Congress on Crime Prevention and Criminal Justice (United Nations Secretariat 2009: 10) noted that the FATF 40+9 Recommendations, as well as the UN's Organised Crime Convention and Convention against Corruption, do not

> contain an express obligation to collect, compare, analyse and disseminate trade data with a view to identifying trade-based money-laundering schemes and facilitating investigations and prosecutions of the persons involved therein

but these Recommendations and Conventions:

> set out a general obligation for member States to properly investigate money-laundering offences, and to do that, the money-laundering offence needs to be defined broadly to include trade-based money-laundering schemes (United Nations Secretariat 2009: 10).

However, the same paper noted that

> the provisions of the two conventions and the FATF recommendations are rather general and give Member States little guidance on how to best implement their obligations (UN Secretariat 2009: 11).

Combating trade-based money laundering—FATF's best practices

In 2008, FATF produced a *Best Practices Paper* for combating TBML (FATF 2008a). The aim of this report was

> to improve the ability of competent authorities to collect and effectively utilise trade data, both domestically and internationally, for the purpose of detecting in a risk-based manner and investigating money laundering and terrorist financing through the trade system (FATF 2008a: 1).

Rather than transferring the 40+9 Recommendations that applies to AML/CTF to TBML, the emphasis of the FATF *Best Practices Paper* was to raise awareness of the issue of TBML and recommend the collection of data that may help identify TBML activities. At this stage, more needs to be done at the international level to understand the phenomenon of TBML before FATF or individual countries can establish regulations to tackle TBML.

To build this awareness of TBML and to gather, as well as disseminate, information about this form of money laundering, the FATF *Best Practices Paper* proposed:

- A stronger awareness of TBML, with countries 'to incorporate TBML/TF into existing training programs on AML/CTF'.
- Extending TBML training to relevant staff of

  > trade authorities, investigative authorities, customs agencies, tax authorities, the financial intelligence unit, prosecutorial authorities, banking supervisors and any other authorities that the country identifies as being relevant to the fight against TBML/TF (FATF 2008a: 2).

- Continued efforts to 'tailor training programmes to meet the specific requirements and needs of different authorities' (FATF 2008a: 3). For example

  > training programs for analytical and investigative authorities could include a focus on the existence and relevance of financial and trade data to crime targeting, and techniques for conducting such analysis (FATF 2008a: 3).

- Sectors, such as financial institutions, that have customers dealing in trade transactions should be made aware of TBML and should

  > include in training programs for banking supervisors a focus on the importance of evaluating the adequacy of a bank's policies, procedures and processes for handling trade finance activities (FATF 2008a: 4).

- Outreach and awareness raising concerning TBML/TF issues be conducted with private sector organisations not listed above.
- Training should not be limited to one format, with countries encouraged to

  > consider using a combination of delivery methods, such as: offering or participating in conferences, seminars, workshops and other events; developing internet-based learning tools (e-learning); publishing guidance; posting information on the websites of competent authorities; including relevant information in the annual reports or other publications of competent authorities; or sending relevant materials to contacts directly (FATF 2008a: 4).

- As part of the general awareness raising and education about TBML, 'countries could agree to make case studies and red flag indicators identified in the [FATF] typologies report available to competent authorities and financial institutions' (FATF 2008a: 4).
- Financial institutions to include case studies, red flag indicators and FATF typologies 'in their internal guidance and training manuals, and to keep their employees informed of developments in the area of TBML/TF' (FATF 2008a: 5).
- Countries conduct further study of TBML/TF at the national and regional level to improve understanding of TBML and identify TBML typologies.
- The collation of this information is also important, with countries encouraged to 'develop a domestic mechanism to link the work of authorities responsible for investigating money laundering and terrorist financing' (FATF 2008a: 5).

- That countries should
  - first identify where trade data and relevant financial information are being stored' and to 'ensure that there are clear and effective gateways, mechanisms and channels that allow the investigative authorities access, directly or indirectly, on a timely basis to trade data and relevant financial information (FATF 2008a: 5).
- The establishment of 'memoranda of understanding, information sharing agreements, the use of liaison officers and the establishment of multi-agency task forces' or

  a specialised unit that has designated responsibility for monitoring imports and exports, analysing trade data and identifying anomalies with a view to detecting TBML/TF and other illicit activity, and supporting related investigations and prosecutions (FATF 2008a: 5)

  such as a Trade Transparency Unit.
- That Financial Intelligence Units should also have access to the information gathered.
- The information gathered and disseminated should 'only be conducted in an authorised manner and consistent with a country's domestic privacy and data protections laws' (FATF 2008a: 6).
- This information should be stored in 'a national electronic secure database which can only be accessed by the appropriate authorities for the purpose of discharging their official duties' (FATF 2008a: 6), with data to be redacted or sanitised if necessary.
- That in order to foster international cooperation on anti-TBML matters, 'countries could establish clear and effective gateways...to facilitate the prompt and effective exchange of trade data and other relevant information' (FATF 2008a: 7).
- Inter cooperation that could also extend to 'mutual legal assistance in TBML/TF investigations and prosecutions' (FATF 2008a: 7).
- Countries should explore the possibility of sharing datasets, through transnational/regional databases or '[r]egional or international information exchange platforms' (FATF 2008a: 7).
- That anti-TBML activities should be undertaken 'with a view to ensuring that legitimate trading activities are not unreasonably hindered or obstructed' (FATF 2008a: 7).
- Countries are encouraged to ensure competitive neutrality and economic efficiency when implementing measures to tackle TBML.

The last point of the FATF's *Best Practices Paper* (2008a) outlines measures which could be taken by countries to combat TBML without hindering legitimate trading activities. These are:

- applying an intelligence, risk-based and target-based approach which makes consistent use of TBML/TF red flag indicators;
- using data capture mechanisms so that information can be electronically exchanged between authorities from one computer system to another;
- authorising traders that meet certain criteria to benefit from facilitations for customs controls or simplifications for customs rules;
- utilising trade data that is gathered automatically from customs declaration forms, thereby avoiding any extra burden for the traders who are involved in legitimate trade;
- conducting non-intrusive inspections of goods being imported and exported using scanners;
- having authorising domestic authorities (eg customs, Financial Intelligence Units) share information either upon specific request or spontaneously;
- providing information to foreign authorities and placing conditions on the use of such information; and
- establishing a TTU to facilitate the sharing and analysis of import/export data. Because the system does not rely on real-time information to target trade transactions (the system uses historic data to identify anomalies that are indicative of TBML/TF), legitimate trading activities will not be unreasonably hindered.

However, some, such as Delston and Walls (2009), have argued that there needs to be greater harmonisation between the FATF Best Practices Paper for combating TBML and the 40+9 Recommendations updated by FATF in 2004, calling for traders to adopt Customer Due Diligence, Know Your Customer and Suspicious Activity Reports reporting protocols, which financial institutions and DNFBPs are compelled to do under current AML/CTF standards. Delston and Walls' (2009) proposals

would seem to be at odds with the recommendations put forward in the *Best Practices Paper*, particularly the concept of attempting not to put further regulatory burdens upon legitimate trading activities. However, they do warn that 'companies may ignore their TBML risk only at their peril' (Delston & Walls 2009: 118) and suggest that businesses may voluntarily go beyond FATF's Best Practices to safeguard themselves against TBML threats.

Table 2 Trade-based money laundering red flags

1. Inability of a bank customer to produce trade documentation to back up a requested bank transaction
2. Significant discrepancies appear between the description of the commodity on the bill of lading and the invoice
3. Significant discrepancies appear between the description of the goods on the bill of lading or invoice and the actual goods transported
4. Significant discrepancies appear between the value of the commodity reported on the invoice and the commodity's fair market value
5. Shipment locations or description of goods that are inconsistent with the letter of credit
6. Documentation showing a higher or lower value or cost of merchandise than that which was declared to Australian Customs and Border Protection or paid by the importer
7. A transaction that involves the use of amended or extended letters of credit that are amended significantly without reasonable justification or that include changes to the beneficiary or location of payment
8. A third party paying for the goods
9. A consignment that is inconsistent with the business (eg a steel company that starts dealing in paper products, or an information technology company that suddenly starts dealing in bulk pharmaceuticals)
10. Customers conducting business in high-risk jurisdictions. Although not specifically identified by the US Federal Financial Institutions Examination Council or FATF, FTZs may be added to the list of high-risk jurisdictions given that there is an argument that FTZs exacerbate the risk
11. Customers shipping items through high-risk jurisdictions, including transit through non-cooperative countries
12. The commodity is transhipped through one or more jurisdictions for no apparent economic reason
13. Customers involved in potentially high-risk activities, including those subject to export/import restrictions such as equipment for military or police organisations of foreign governments, weapons, ammunition, chemical mixtures, classified defence articles, sensitive technical data, nuclear materials, precious gems, or certain natural resources such as metals, ore and crude oil
14. Obvious over- or under-pricing of goods and services
15. Obvious misrepresentation of quantity or type of goods imported or exported
16. A transaction structure that appears unnecessarily complex so that it appears designed to obscure the transaction's true nature
17. A shipment that does not make economic sense (eg the use of a large container to transport a small amount of relatively low value merchandise)
18. Consignment size appears inconsistent with the scale of the exporter or importer's regular business activities
19. The type of commodity being transported appears inconsistent with the exporter or importer's usual business activities
20. The method of payment appears inconsistent with the risk characteristics of the transaction, for example the use of an advance payment for a shipment from a new supplier in a high-risk country
21. A transaction that involves receipt of cash or payment of proceeds (or other payments) from third-party entities that have no apparent connection with the transaction or which involve front or shell companies
22. A transaction that involves commodities designated as high risk for money laundering activities, such as goods that present valuation problems or high value, high turnover consumer goods

Source: Brannigan 2010; Brown 2009: 10–12; FATF 2006: 24; US FFIEC 2010: Appendix F: F–5

Trade-based money laundering red flags

The US Federal Financial Institutions Examination Council AML manual and FATF have identified a number of indicators of TBML activities. These 'red flags' are predominantly based on activity observed in Suspicious Activity Reports in the United States, which indicate possible TBML. The red flags are not proof of illegal activity. They are indicators that money laundering may be occurring which should prompt further investigation, having regard to other factors including the normal transaction activity expected for the customer, the good or service traded, its value and geographical location.

When combined, the indicators listed by the US Federal Financial Institutions Examination Council and FATF form a comprehensive list of red flags for TBML, which is applicable to both the trade and financial sectors. These are listed in Table 2.

Trade Transparency Units

To date, there has been little regulatory action taken by individual countries to target TBML specifically. The creation of TTUs by the United States and their implementation in several South American countries provide one example of how countries may institute regulations to combat TBML. In 2004, the US ICE established TTUs to combat TBML and other import–export crimes. These TTUs rely on data analysis of international trade patterns to identify potential TBML activities. The TTUs in the United States use the Data Analysis and Research for Trade Transparency Systems (DARTTS), which

> allows investigators to view totals for merchandise imports and then sort on any number of variables, such as country of origin, importer name, manufacturer name, and total value (US DHS 2010: 3).

Through this, DARTTS identifies trade and financial transactions that are 'statistically anomalous based on known facts and user queries', rather than being used to 'predict future behaviour' or to 'profile' traders (US DHS 2010: 3) The data that DARTTS uses are collected from US Customs, the US Bureau of Census (where historical trade data are held), FinCEN and foreign government bodies, and consists of information gathered from those required to complete import–export forms (US DHS 2010).

From this collection of data, three types of analysis are conducted by DARTTS:

- *International Trade Discrepancy Analysis*—US and foreign import/export data are compared to identify anomalies and discrepancies that warrant further investigation for potential fraud or other illegal activity.
- *Unit Price Analysis*—trade pricing data are analysed to identify over- or under-valuation of goods, which may be an indicator of TBML or other import–export crimes.
- *Financial Data Analysis*—financial reporting data (the import/export of currency, deposits of currency in financial institutions, reports of suspicious financial activities and the identities of parties to these transactions) are analysed to identify patterns of activity that may indicate illegal money laundering schemes (US DHS 2010: 110).

When conducting this analysis, the TTU in the United States relies heavily upon information gathered from other countries. A report by US ICE (2011a: 2–3) explained that for TBML to work, 'one of the primary factors criminals rely on...is the idea that a customs agency can only see one side of a trade transaction', but for example:

> if both the U.S. and Brazilian customs agencies could see each other's trade paperwork, the transaction becomes transparent, allowing law enforcement personnel to identify fraudulent transactions indicative of money laundering.

This has meant that the United States has established TTUs with important trading partners, such as Argentina, Brazil, Colombia, Paraguay, Mexico and Panama, with the possibility of setting them up in Central and Eastern Europe as well (McSkimming 2010; US ICE 2011b). The United States hopes that this network of TTUs will expand and 'provide a forum for the open exchange of trade data between all participating countries' (US ICE 2011b: np).

According to US ICE's annual report for 2008 (US ICE 2008: vi), the data analysis of the TTUs in the United States and overseas had 'launched 51 investigations leading to seizures of $4.5 million'. A later report outlines two more recent successful cases (US ICE 2011a). The first resulted in

> four individuals and three Miami based freight forwarding companies [being] indicted on conspiracy charges for violating the International Emergency Economic Powers Act…and the smuggling of electronic goods (US ICE 2011a: 4)

with over $119m of merchandise seized. The second saw several defendants and a top company charged with money laundering offences, as well as other offences, with 'a criminal forfeiture indictment of $8.6 million for structured assets...also filed' (US ICE 2011a: 4).

However, it has been noted that the '[s]et up costs and efforts are somewhat prohibitive' for TTUs and rely on the political will of certain countries like the United States, who are 'commonly having to provide start-up funding, assistance in systems upgrading, equipment, and training for the newly functioning unit (Liao & Acharya 2011: 83). These costs may deter governments from implementing these kinds of regulatory units, particularly while the effects of the Global Financial Crisis are still being felt and while more research into TBML outside of the Americas needs to be done.

In examining the global responses to TBML, particularly the recommendations set out by FATF and the approach taken by the US Government, it is evident that the emphasis is on information gathering and the analysis of data to identify possible TBML activities, with a secondary focus on sharing this information with relevant agencies and authorities. FATF's (2008) *Best Practices Paper* highlights education and awareness of TBML as paramount to combating it, as an understanding of TBML is required to assess what information needs to be gathered about trade. The TTUs established by US ICE are an example of how the information gathering on TBML is put into practice, using statistical analysis to identify suspicious activities and possible TBML activities. However, it has been noted that TTUs have high start-up and administration costs, which may make them a less attractive option for other countries. The viability of establishing TTUs in Australia seems remote while there remains much unknown about TBML in this country.

Tackling trade-based money laundering in Australia and the way forward

In 2005, FATF conducted its third review of Australia's money laundering and terrorist financing regime (FATF 2005) and found that Australia did not comply with all of the 40 Recommendations and 9 Special Recommendations. Partially as a consequence of this, Australia introduced new legislation (the AML/CTF Act) and amendments have been made in subsequent years to address the concerns raised by FATF. Within FATF's review, there was a perception that the previous legislative regime had been too prescriptive and cumbersome, resulting in 'defensive reporting', a practice that threatened to overload regulators with information of dubious relevance and accuracy (Ross & Hannan 2007: 139). It was also considered to be an inflexible response to new developments in money laundering techniques (Ross & Hannan 2007).

Therefore, the AML/CTF Act was introduced in late 2006. In keeping with most comparable regulatory regimes (such as those in the United States and in the United Kingdom), Australia's current AML/CTF regime is risk based. The regime requires businesses supplying designated services to comply with the legislation but leaves it to the discretion of the affected parties as to how they meet some of these obligations. The focus in the legislation is on the nature of the service rather than on the nature of entity that supplies it. The reporting entity, rather than AUSTRAC, is given responsibility for both determining the level of risk represented by any customer and any transaction, and the appropriate response. Responsibilities, such as Customer Due Diligence, show a change in emphasis from a regulatory 'tick and flick' based regime to one that emphasises the responsibility of reporting entities to maintain ongoing knowledge of their customers. The presumption is that a risk-based regime allows financial bodies (which presumably have more practical experience in dealing with actual clients) to be given more latitude in determining what level of risk any particular client or transaction represents and how best to manage that risk (Ross & Hannan 2007).

Under the AML/CTF Act, a large range of entities are regulated. AUSTRAC has identified over 14,000 entities with obligations under the current legislation (AUSTRAC 2010a: 24). Although AUSTRAC is the AML/CTF regulator in Australia, it does not have any law enforcement or prosecutorial powers. As a result, it is an administrative-style Financial Intelligence Unit that supplies information to a wide variety of government bodies. The financial intelligence it provides is used by these partner agencies to investigate cases of alleged financial crime, which may then be referred for investigation by police and prosecution.

The AML/CTF Act covers industry services who also have obligations under the *Financial Transaction Reports Act 1988* (Cth), including the prudentially regulated financial sector and a range of other designated businesses. The following is a list of the currently regulated sector under the AML/CTF Act (designated entities within each regulated sector appear in parentheses):

- banking (banks, building societies, credit unions, finance corporations, friendly societies, housing societies, merchant banks, SWIFT);
- alternative remittance (corporate remitters, remittance providers);
- securities/derivatives (futures brokers, mortgage and finance providers, securities dealers);
- managed funds/superannuation (investment companies, managed funds, Principle or Discretionary, traders, retailers, superannuation trusts, unit trusts);
- gambling (casinos, gambling houses, on course bookmakers, pubs and clubs, sports bookmakers, TABs);
- foreign exchange (foreign exchange providers, payment service providers, postal and courier service providers, travel agents, travellers cheques issuers); and
- financial services (factorers, forfeiters, hire purchase companies, lease companies, pastoral houses, public authorities).

The Australian Government is currently examining the need to extend the application of the AML/CTF Act to specified services provided by a number of other business and professional sectors. As identified on the Attorney-General's Department website (AGD 2010), the sectors that are likely to be regulated in this second tranche of legislative reforms in Australia include lawyers, accountants, real estate agents, dealers in precious metals and trust and company service providers. Until a decision is made concerning the second tranche of legislative reforms, it cannot be determined with accuracy which professionals and which of their services will be regulated and to what extent. However, among the professions identified, there has been no indication that the government would be extending the Act to traders.

The viability of transferring the anti-money laundering/ counter-terrorism financing framework to trade

Geary has argued that '[t]ranslating money-laundering trends in banking to non-banking businesses does not really work' (Geary 2009: 219). Although some (Delston & Walls 2009) have proposed that implementation of a regulatory AML/CTF program for trade may seem relatively straightforward, by building on an established scheme of monitoring and reporting of suspicious transactions by financial institutions and DNFBPs, it is expected to be a rather costly and complex exercise. McSkimming (2010: 51), for example, questioned whether a trader or trading company 'would be in a position to observe a transaction in its entirety, and thus be in a position to meaningfully comply with a reporting obligation'. Further, he wrote:

> Traders though, are not banks. By and large, they lack the sophisticated and entrenched institutional mechanisms for compliance that exist in financial institutions. They lack customer relationship management platforms; indeed, they often have little direct contact with customers at all. They are lightly regulated in many respects and are directed at a diverse range of industry sectors—from consumer transactions to bulk-material shipping. Given this, how authorities will regulate traders in order to monitor billions of transactions, encompassing millions of containers, in a cost-effective and efficient way is the great, uncontemplated challenge of TBML/TF enforcement (McSkimming 2010: 63).

Although there would likely be some benefits in extending the AML/CTF regime to trade, the costs and logistics of implementation raise major concerns, particularly as TBML remains an under-researched area with a lack of data. As McSkimming (2010: 49) argued, '[w]ith counter-TBML/TF efforts likely to be costly, the lack of data makes the case for increased law enforcement resources difficult to make'.

In addition, the budgetary impacts on regulatory agencies such as AUSTRAC need to be considered.

The addition of potentially tens of thousands of new reporting entities are likely to require a substantial reworking of AUSTRAC's supervisory and intelligence strategies and a large injection of additional funding (eg to accommodate cost and resource implications associated with the establishment of a dedicated business intelligence function and the need to upgrade or enhance technologies to accommodate additional information).

Applying the current AML/CTF framework to trade would also require a large volume of resources to ensure that regulations were followed and to analyse the information gathered if traders were made legally mandated reporting entities. This would conflict with government policy to minimise the impact of regulatory measures upon businesses (especially small businesses). As the Department of Finance and Deregulation (2010: np) stated on their website concerning 'Best Practice Regulation Making':

> Regulations are essential for the proper functioning of society and the economy. The challenge for Government is to deliver effective and efficient regulation—regulation that is effective in addressing an identified problem and efficient in terms of delivering benefits *while minimising the costs to the economy* (emphasis added).

Applying FATF's Best Practices guidelines in Australia

An alternative approach to address TBML/TF is to engage in capacity building and awareness raising, both within government agencies and with existing reporting entities who facilitate trade through the provision of financial or logistical services such as financial institutions, money service businesses, postal and courier service providers. This approach is also in line with the objective of FATF's report on TBML:

> [T]here are a number of practical steps that can be taken to improve the capacity of national authorities to address the threat of trade-based money laundering. Among these are the need for a stronger focus on training programs to better identify trade-based money laundering techniques, the need for more effective information sharing among competent authorities at the national level, and greater recourse to memoranda of understanding and mutual assistance agreements to strengthen international cooperation (FATF 2006: i).

FATF encourages member jurisdictions to provide training on TBML techniques to staff of various government authorities including trade, investigative, customs, tax, prosecutorial authorities, as well as Financial Intelligence Units and supervisors of financial institutions, and conduct outreach and awareness raising with the private sector concerning TBML issues. This includes dissemination of TBML typologies, red flag indicators and sanitised case studies as covered in the previous chapter.

Countries are also encouraged by FATF to facilitate joint meetings of relevant domestic authorities to discuss and share new and emerging TBML/TF trends and patterns. Part of this approach could include the routine comparison of existing information obtained through financial transaction reports with trade data obtained from ACBPS. FATF also recommends that jurisdictions conduct joint investigations or collaborate with foreign authorities and participate in the work of relevant regional and international organisations. Importantly, FATF urges jurisdictions to keep the following considerations in mind when implementing measures to combat TBML/TF:

- competitive neutrality;
- competition and economic efficiencies;
- the desirability of ensuring that regulatory considerations are addressed in a way that does not impose unnecessary financial and administrative burdens on reporting entities; and
- the risk that commercially sensitive information could be misused (for purposes other than combating TBML/TF).

Looking at the specific recommendations made in FATF's Best Practices Paper, Australian agencies involved in overseeing AML/CTF obligations are most readily able to institute the recommendations that concern education and awareness. One of AUSTRAC's policy goals is educating people about AML/CTF practices and the function of, and how to comply with, the AML/CTF Act. AUSTRAC's (2010a) latest annual report demonstrated that it has engaged in numerous education and awareness raising initiatives, as well as holding forums, meeting with peak industry bodies and issuing circular notes. The agency produced 11 editions of its electronic newsletter *AUSTRAC e-news* (which provides updates on the AML/CTF environment in Australia

and overseas), whose subscriptions grew from 831 in July 2009 to 2,658 in June 2010. They also established a Help Desk that fielded 17,680 calls and 5,487 emails, and other written enquiries (AUSTRAC 2010a). AUSTRAC also produced four e-learning modules on AML/CTF matters, which are publicly accessible on the AUSTRAC website. However, AUSTRAC's education and awareness training at the moment is focused on regulated entities and targeted towards certain industries to encourage voluntary compliance with the AML/CTF Act (AUSTRAC 2010a, 2010b). The forms of education that AUSTRAC undertake, such as seminars, forums, e-learning and circulars could all be easily adapted to raise awareness of TBML.

Alongside educating regulated entities, AUSTRAC is also involved in education and training support for AUSTRAC's partner agencies, which are classified into five categories—the Australian Tax Office, Australian Government law enforcement and regulatory agencies, Australian social justice agencies, state and territory law enforcement agencies, and state and territory revenue agencies. In 2009–10, AUSTRAC conducted 258 training sessions for 660 users of AUSTRAC's online enquiry system, which saw an increase in usage by 135 percent in the same year (AUSTRAC 2010a: 3). AUSTRAC also held 57 presentations and awareness sessions on a range of topics, including money laundering typologies (AUSTRAC 2010a). It is not indicated in the annual report whether these sessions addressed TBML, but could be easily accommodated into future training sessions.

The other significant recommendations by the *Best Practices Paper* revolve around the collection and dissemination of trade data. In Australia, this information is collected by the Department of Foreign Affairs and Trade and ACBPS. As mentioned earlier in this report, the establishment of a TTU in Australia, similar to the one that exists in the United States and is recommended by FATF, looks unlikely to occur due to the set up and running costs and the added layers of administration. However, closer working relationships between Department of Foreign Affairs and Trade, ACBPS and AUSTRAC may help to create a greater understanding of (and possibly identify) potential TBML activities in Australia.

Challenges ahead

The most significant challenge is that TBML, like other types of money laundering, will continue to develop and new typologies will undoubtedly emerge. In a statement as apt today as when it was made, FATF observed that:

> There are likely to be illicit financing methods being used that have not been detected by financial institutions or law enforcement, and so will not show up in the data gathered from criminal investigations or financial institution currency or transaction reporting. And there may be other illicit financing options that even the criminals have not yet discovered. In the absence of data or case studies identifying these methods, financial institutions and competent authorities must rely on creative intuition and a careful analysis of potential systemic weaknesses (FATF 2008b: 5).

This statement highlights several important points which are borne out by this research. First, the evolving, and often ingenious, nature of money laundering highlights the need to anticipate new developments and trends. Second, it emphasises the importance of information and analysis in informing and shaping an effective AML/CTF strategy.

These points indicate that, to be most effective, ongoing monitoring and assessment of TBML will be necessary to address potential new developments, such as the move from money laundering using international merchandise trade to services and from international trade to domestic trade. New trading forums such as virtual trading will also need to be considered. Several authors (Choo & Smith 2008; Irwin & Slay 2010; Lee 2009) have noted that trading in online gaming and social network environments, such as World of Warcraft and Second Life, can be used for money laundering purposes. At present there is little known about these areas but they may be likely areas for the next evolution of TBML.

Future research

TBML has been described in this report as an emerging arm of money laundering that needs to be addressed. It has also looked at how different agencies, particularly FATF and US ICE have sought to combat TBML. However, there is still much more

to understand about the prevalence and typologies of TBML, which needs further research before any practical measures are considered. This is especially the case in Australia, where there is little indication, from public records at least, that TBML is occurring in this country.

This report has identified five suggestions for future research into TBML:

- The investigation of the occurrence of TBML in Australia. Any research should take into account the possibility that some instances of money laundering may include TBML activities, (such as the case of Paul Anthony Miller) but are not recorded as such. Research may be pursued through the examination of publicly available records, or in conjunction with intelligence and law enforcement agencies.
- There needs to be further research into the impact of international TBML on Australia and whether some trading partners (and other countries) increase or reduce the risk of TBML for this country.
- There is a need to gain a much more detailed insight into how TBML operates. Specifically, what is the nature of trading relationships and infrastructures that facilitate TBML? Such research could help to identify the points of vulnerability from the TBML offender's perspective, information which could then be exploited by law enforcement agencies in preventing TBML offences.
- There has been a suggestion by some scholars (Delston & Walls 2009) that the Know Your Customer and Customer Due Diligence regulations present in current AML/CTF regulations could be transferred to traders. Although it would be difficult to make these actions compulsory for traders, research could usefully be conducted into whether voluntary measures to obtain greater knowledge about trading partners/customers/financiers within the trading industry (such as Know Your Customer and Customer Due Diligence) would have an effect upon detecting and preventing TBML.
- The US' TTUs have been cited as a possible way of combating TBML. Research to determine whether a TTU would be effective in the Australian context would be a valuable addition to the field; the Australian Institute of Criminology has an interest in pursuing such research with other relevant government agency partners.

Conclusion

Australia's current AML/CTF laws were implemented gradually from 2006 to prevent money laundering and terrorism financing through the financial system. At present, the scope of reporting entities is limited to banks and other financial institutions, insurance companies, securities and investment companies, gambling services, bullion dealers and alternative remittance services. It has been proposed that regulation may extend to a second tranche of reporting entities (including lawyers, accountants, real estate agents, dealers in precious metals and trust and company service providers), although this has not occurred yet. However, even the second tranche of reporting entities is unlikely to incorporate businesses involved in international and domestic trade.

Extending the current AML/CTF regulatory regime to trading entities would impose a substantial burden on business and entail difficult administrative measures to monitor compliance—issues identified recently by Liao and Acharya (2011) in relation to TTUs established by the United States.

In its *Best Practices Paper*, FATF (2008a) has recommended that a non-restrictive and narrower approach be taken to tackling TBML, emphasising education and awareness building of TBML as a potential crime and enhanced gathering of information. With the Australian Government looking to minimise the regulatory burden upon business and trade, the agencies involved in AML/CTF measures in Australia, primarily AUSTRAC, have embraced these recommendations by FATF. One of AUSTRAC's guiding policies is educating people about the risks of money laundering and terrorism financing (as well as how to combat this) and it is noted that future education and awareness-raising programs could usefully incorporate a discussion of TBML. However, it is argued that the formation of a regulatory framework to deal with TBML may be premature and that more research needs to be conducted to first ascertain with greater precision the nature, risks and prevalence of TBML in Australia.

References

All URLs were correct at October 2011

Asia/Pacific Group on Money Laundering (APG) 2008. *APG typologies report 2008*. http://www.apgml.org/documents/docs/6/APG_2008_Typologies_Rpt_July08.pdf

Attorney-General's Department (AGD) 2010. *Second tranche of reforms*. http://www.ag.gov.au/www/agd/agd.nsf/Page/Anti-moneylaundering_SecondTrancheofReforms?open&query=second tranche

Australian Crime Commission (ACC) 2011. *Organised crime in Australia*. Canberra: ACC

AUSTRAC 2010a. *Annual report 2009–10*. Canberra: AUSTRAC

AUSTRAC 2010b. *Education policy*. http://austrac.gov.au/education_policy.html

Bagella MB, Busato F & Argentiero A 2009. Money laundering in a microfounded dynamic model: Simulations for the U.S. and the EU–15 economies. *Review Of Law and Economics* 15 (2): 879–902

Baker R 2005. *Capitalism's Achilles heel*. Hoboken, NJ: John Wiley & Sons

Brannigan M 2010. Crooks misusing foreign trade. *Miami Herald* 19 February: 1C Business

Brown HA 2009. Free trade zones: Haven for money laundering and terrorist financing? *ACAMS Today* January: 10–12

Choo KKR & Smith RG 2008. Criminal exploitation of online systems by organised crime groups. *Asian Journal of Criminology* 3(1): 37–59

Delston R S & Walls SC 2009. Reaching beyond banks: How to target trade-based money laundering and terrorist financing outside the financial sector. *Case Western Reserve Journal of International Law* 41 (8): 85–118

Department of Finance and Deregulation (DFD) 2010. *Best practice regulation making*. http://www.finance.gov.au/obpr/proposal/index.html

Department of Foreign Affairs and Trade (DFAT) 2010a. *Trade at a glance 2010*. http://www.dfat.gov.au/publications/trade/trade_at_a_glance_2010.pdf

Department of Foreign Affairs and Trade (DFAT) 2010b. *Australia fact sheet*. http://www.dfat.gov.au/geo/fs/aust.pdf

EAG Working Group on Typologies 2009 *International trade-based money laundering.* http://eurasiangroup.org/restricted/WGTYP_report_3_2009_62_eng.doc

Financial Crimes Enforcement Network (FinCEN) 2010. *Advisory to financial institutions on filing suspicious activity reports regarding trade-based money laundering.* http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2010-a001.pdf

Felsenfeld C & Bilali G 2004. The role for the Bank of International Settlements in shaping the world financial system. *University of Pennsylvania Journal of International Economic Law* 25: 945–1045

Financial Action Task Force (FATF) 2011. *The review of the standards—Preparation for the 4th Round of mutual evaluation: Second public consultation*. http://www.fatf-gafi.org/dataoecd/27/49/48264473.pdf

Financial Action Task Force (FATF) 2010. *Money laundering vulnerabilities of free trade zones.* http://www.fatf-gafi.org/dataoecd/45/47/44888058.pdf

Financial Action Task Force (FATF) 2008a. *Best practices paper on trade based money laundering.* http://www.fatf-gafi.org/dataoecd/9/28/40936081.pdf

Financial Action Task Force (FATF) 2008b. *Money laundering & terrorist financing risk assessment strategies*. http://www.fatf-gafi.org/dataoecd/46/24/40978997.pdf

Financial Action Task Force (FATF) 2006. *Trade based money laundering*. http://www.fatf-gafi.org/dataoecd/60/25/37038272.pdf

Financial Action Task Force (FATF) 2005. *Third mutual evaluation report on anti-money laundering and combating the financing of terrorism: Australia*. http://www.fatf-gafi.org/dataoecd/60/33/35528955.pdf

Financial Action Task Force (FATF) 2004. *FATF IX special recommendations.* http://www.fatf-gafi.org/dataoecd/8/17/34849466.pdf

He P 2010. A typological study on money laundering. *Journal of Money Laundering Control* 13(1):15–32

Geary J M 2009. Light is the best antidote. *Journal of Money Laundering Control* 12(3): 215–220

Irwin ASM & Slay J 2010. *Detecting money laundering and terrorism financing activity in Second Life and World of Warcraft*. Proceedings of the 1st International Cyber Resilience Conference. Perth: Edith Cowan University

Lee CY 2009. *Understanding security threats in virtual worlds*. Americas Conference on Information Systems 2009 Proceedings Paper 446. http://aisel.aisnet.org/amcis2009/466/

Levi M & Reuter P 2006. Money laundering. *Crime and Justice* 34: 289–375

Liao J & Acharya A 2011. Transshipment and trade-based money laundering. *Journal of Money Laundering Control* 14(1): 79–92

Lormel DM 2009. *Identifying and disrupting funding streams to thwart terrorist financing and organized criminal operation*. http://www.ipsaintl.com/news-and-events/articles/pdf/lormel-identifying-and-disrupting-funding.pdf

Malloy MP 2005. *International banking,* 2nd ed. Durham, NC: Carolina Academic Press

Marcussen M 2004. *OECD governance through soft law, in* Mörth U (ed), *Governance and regulation*: *An interdisciplinary analysis*. Cheltenham: Edward Elgar: 103–128

McSkimming S 2010. Trade-based money laundering: Responding to an emerging threat. *Deakin Law Review* 15(1): 37–63

Ross S & Hannan M 2007. Australia's new money laundering strategy. *Current Issues in Criminal Justice* 19(2): 135–150

Shelton D 2000. Law, non-law and the problem of 'soft law,' commitment and compliance: The role of non-binding norms, in Shelton D (ed), *Commitment and compliance: The role of non-binding norms in the international legal system.* Oxford: Oxford University Press: 1–18

Simmons B 2000. International efforts against money laundering, in Shelton D (ed), *Commitment and compliance: The role of non-binding norms in the international legal system.* Oxford: Oxford University Press: 244–263

Unger B 2009. Money laundering—A newly emerging topic on the international agenda. *Review of Law And Economics:* 807–819

United Nations Office on Drugs and Crime (UNODC) 2007. *An assessment of transnational organised crime in Central Asia.* http://www.unodc.org/documents/organized-crime/Central_Asia_Crime_Assessment.pdf

United Nations Secretariat 2009. *International co-operation to address money-laundering based on relevant United Nations and other instruments*. A/CONF.213/8. http://www.unodc.org/documents/crime-congress/12th-Crime-Congress/Documents/A_CONF.213_8/V0989288e.pdf

United States Department of Homeland Security (US DHS) 2010. *Privacy impact assessment for the Data Analysis & Research Trade Transparency System (DARTTS)*. http://www.dhs.gov/xlibrary/assets/privacy/privacy_pia_ice_dartts2.pdf

United States Department of State Bureau for International Narcotics and Law Enforcement Affairs (BINLEA) 2010. *International narcotics control strategy report volume II: Money laundering and financial crimes.* http://www.state.gov/documents/organization/137429.pdf

United States Department of State Bureau for International Narcotics and Law Enforcement Affairs (BINLEA) 2009. *International narcotics control strategy report volume II: Money laundering and financial crimes.* http://www.state.gov/documents/organization/120055.pdf

United States Department of State Bureau for International Narcotics and Law Enforcement Affairs (BINLEA) 2004. *International narcotics control strategy report volume II: Money laundering and financial crimes.* http://www.state.gov/documents/organization/30187.pdf

United States Immigration, Customs and Enforcement (US ICE) 2011a. Homeland security investigations: Trade Transparency Unit. *The Cornerstone Report* 7(3). http://www.ice.gov/doclib/news/library/reports/cornerstone/cornerstone7-3.pdf

United States Immigration, Customs and Enforcement (US ICE) 2011b. *Trade transparency unit*. http://www.ice.gov/trade-transparency

United States Immigration, Customs and Enforcement (US ICE) 2008. *ICE fiscal year 2008 annual report*. http://www.nilc.org/immlawpolicy/arrestdet/ICE-fy2008-annual-report.pdf

United States Immigration, Customs and Enforcement (US ICE) nd. *Trade-based money laundering*. http://www.ice.gov/cornerstone/money-laundering.htm

United States Federal Financial Institutions Examination Council (US FFIEC) 2010. *Bank Secrecy Act/anti-money laundering examination manual.* http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf

Walker J & Unger B 2009. Measuring global money laundering: 'The Walker Gravity Model'. *Review of Law & Economics* 5(2): 821–853

Wirth D A 2000. *Compliance with non-binding norms of trade and finance, in* Shelton D (ed), *Commitment and compliance: The role of non-binding norms in the international legal system.* Oxford: Oxford University Press: 330–344

World Trade Organisation (WTO) 2009. *International trade statistics 2009.* http://www.wto.org/english/res_e/statis_e/its2009_e/its2009_e.pdf

Zdanowicz JS 2009. Trade-based money laundering and terrorist financing. *Review of Law and Economics* 5(2): 858–878

AIC Reports
Research and Public Policy Series 115

This report examines a form of money laundering based on the trade of goods and services, commonly known as trade-based money laundering. Although the global response to trade-based money laundering has been limited so far, more research needs to be conducted into the nature and impact of trade-based money laundering before avenues for reform are pursued in Australia

Australia's national research and
knowledge centre on crime and justice

www.aic.gov.au