

# Statement to the Cullen Commission of Inquiry into Money Laundering in British Columbia

by

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## Overview

I served 26 years as an intelligence officer and a Special Agent for the Department of Treasury of the United States. My areas of expertise are money laundering and threat finance. After my retirement from the U.S. government, I acted as a consultant to government and industry. I have written numerous articles and five books on various topics related to transnational crime, money laundering, and terror finance, including *Trade-Based Money Laundering: The Next Frontier in International Law Enforcement* (Wiley/2016) and *Money Laundering and Illicit Financial Flows: Following the Money and Value Trails* (Amazon/KDP/2020) I am on the Board of Directors of Global Financial Integrity, a Washington D.C. based non-profit that examines illicit financial flows primarily from the developing world.

I have been asked a series of questions by the Cullen Commission that I have reorganized as follows:

1. Please describe the role of the law enforcement expert in the Financial Action Task Force (“FATF”) mutual evaluation process, including your experience in evaluating Canada.
2. Please describe the US approach to collecting intelligence and pursuing enforcement against money laundering, including a breakdown of the relevant players and the work done by each to combat money laundering. Please describe the strengths and challenges of this approach.

3. Please provide an overview of the topic of Trade Based Money Laundering (“TBML”) globally and, to the extent this is known, in Canada and British Columbia, including:
- What is TBML?
  - What is the scope of the problem with TBML?
  - What harms flow from TBML?
  - What are the most prevalent past, present and emerging TBML methodologies and/or typologies? In answering this question, I have addressed invoice fraud, invoice manipulation, service-based money laundering, capital flight and underground finance, and trade finance.
  - I have addressed the following questions together:
    - What is the US approach to combatting TBML?
    - What are the enforcement and intelligence challenges with respect to TBML, in particular?
    - What investigative and/or intelligence techniques and methods can be effectively used to detect and deter TBML?
    - What opportunities are there to improve detection and prevention of TBML?
  - Please discuss the emerging use of data and advanced analytics to detect TBML.
  - Is Canada in general, and British Columbia in particular, vulnerable to TBML? Why or why not?

The structure of this report begins with responses to the questions outlined above. It concludes with recommendations for a more effective strategy against TBML. In addition, please see Appendix 1 – Red Flag Indicators for Trade-Based Money Laundering; Appendix 2 – Trade Transparency Unit Members; and Appendix 3 – List of Acronyms.

## **FATF Mutual Evaluation Process and Role of the Law Enforcement Expert**

In 1989, the G-7 created the FATF. The international anti-money laundering (AML) policy making body created and championed 40 recommendations for countries and jurisdictions around the world. The recommendations cover the establishment and effective implementation of AML and, after September 11, counter-terrorist finance (CFT) measures.

Canada has been a member of the FATF member since 1990. Over the years, FATF-style regional bodies (FSRBs) have spread around the world. The nine FSRBs are autonomous regional organizations that help the FATF implement its global AML/CFT policies in over 200 affiliated countries. Canada is also a member of the Asia Pacific Group (APG), a FSRB. Canada is one of the Co-operating and Supporting Nations (COSUNs) of the Caribbean Financial Action Task Force (CFATF) and an observer to the Latin America Anti-Money Laundering Group (GAFILAT).

Periodically, FATF and FSRB members undergo peer mutual evaluations to ascertain how member countries adhere to the FATF recommendations. The evaluation process results in a mutual evaluation report (MER).<sup>‡</sup>

The FATF evaluation process is conducted by a team commonly comprised of four to six selected experts in the legal, financial and law enforcement fields of FATF member governments other than that of the country being evaluated. For larger countries or those with complex issues the evaluation team is sometimes larger. The team is headed by a member of the FATF Secretariat. During the evaluation process, the team makes an on-site visit to the country being evaluated. Generally speaking, the team is in-country three to five days. They interview representatives of relevant government agencies and departments, the Central Bank, financial sector, and other institutions and bodies. At the conclusion of the review, the team writes a detailed report which provides an assessment of the extent to which the evaluated country has made progress in implementing a compliant and effective AML/CFT regime as measured against the FATF 40 recommendations. The report highlights areas that are not compliant or ineffective. The report is designed to help the concerned make any needed AML/CFT reforms.

In 1997, I was invited by the FATF Secretariat to be the FATF “law enforcement expert” during the FATF’s second mutual evaluation of Canada. During the MER process, I represented

the FATF. I did not represent the United States or my then employer, the U.S. Customs Service detailed to the Department of Treasury's Financial Crimes Enforcement Network (FinCEN). During the evaluation, I participated in the fact-finding process including interviews of Canadian government officials at policy and operational levels, regulators and supervisors of financial institutions and designated non-financial businesses and professions (DNFBPs), the Royal Canadian Mounted Police, prosecutorial and judicial authorities, and customs and tax authorities. I primarily asked law enforcement related questions related primarily to capacity, resources, cooperation, and effectiveness. In our discussions, I provided law enforcement related context. My frame of reference was influenced by both my U.S. domestic and international law enforcement experiences and observations. In writing the evaluation, I focused my efforts on the law enforcement sections of the report.

The second FATF evaluation of Canada and resulting MER took place over 20 years ago. I do not remember the details of the discussions. At the time, one of the primary concerns was about new AML legal and regulatory tools. For example, Canada was in the process of creating the Canadian Financial Intelligence Unit (FINTRAC). There was discussion about the role and duties of FINTRAC and the collection, warehousing, analysis, and dissemination of financial intelligence and the need for enhanced legislation. I remember that many of the officials that we spoke to (outside of the RCMP) sugarcoated Canadian law enforcement issues. When I spoke to various individuals and institutions, they communicated that Canada did not have problems with major law enforcement issues including narcotics, organized crime, money laundering, tobacco smuggling, etc. I knew that was not the case. Canada's proximity to the United States suggests Canada will have some of the same criminal groups, trafficking organizations, threats and challenges. My sense was that there were many enforcement related issues that were not being adequately addressed. The RCMP seemed to agree with me.

As noted, the mutual evaluation process is designed to provide a balanced appraisal of a country's AML/CFT efforts and spur necessary changes. Twenty years ago, Canada was not in compliance or only partially compliant with many of the FATF 40 recommendations. This was often the norm for an early MER. Canadian officials asked that we put shortcomings in the MER so they could use the results of this MER to promote legislative and regulatory changes.

Today, Canada has a rigorous AML/CFT detection and monitoring process in place. On paper it works well. However, the FATF process is not a paper exercise. The success of a country's AML/CFT regime is best judged on results. From a law enforcement perspective, the results are measured primarily by forfeitures and convictions based on money laundering and/or the predicate offenses. My opinion is that a focus on money laundering convictions is of primary importance because an emphasis on money hurts criminal organizations. When the quantum of likely money laundering is taken into account, Canada's money laundering conviction rate appears to be low.<sup>ii</sup> According to analysis by Statistics Canada, from 2000-2016, Canada only recorded 321 guilty verdicts in money-laundering cases.<sup>iii</sup> By comparison, the number in the United States is approximately 1200 per year.

In 2012, the FATF revamped its evaluation procedures to place more emphasis on enforcement results. I have not been involved in the MER process since these revisions. As of 2018, the level of country compliance with the FATF 40 recommendations was just 32 percent for countries most recently assessed.<sup>iv</sup> Moreover, most countries are failing when it comes to the enforcement metrics that matter: successful money laundering convictions and forfeitures of illicit proceeds. I will elaborate on this when I discuss the U.S. AML record below.

## **U.S. Anti-Money Laundering Enforcement**

Within the U.S. federal government, a number of agencies and departments play a role in working to combat money laundering, including TBML. These include the Department of Homeland Security (DHS), the Department of Justice (DOJ), the State Department, and the Department of Treasury and their component agencies and offices. The following is a brief description of the role each plays in AML enforcement, including the focus on TBML:<sup>v</sup>

- **DHS:** within DHS, Immigration and Customs Enforcement's (ICE's) Homeland Security Investigations (HSI) investigates financial crimes and money laundering cases, including customs fraud, smuggling, and almost all crimes related to the border including those involving TBML. Per the more detailed description below, HSI has established a Trade Transparency Unit (TTU) that seeks to identify global TBML trends, provide investigation support to HSI and other law enforcement efforts, and conduct ongoing analysis of trade data provided through partnerships with TTUs that it has helped

establish in other countries. Customs and Border Protection (CBP) is responsible for enforcing U.S. trade laws, facilitating trade, collecting revenue, and protecting the U.S. economy and consumers from harmful imports and unfair trade practices. As part of its mission, CBP conducts targeting of high-risk shipments that may involve trade violations, including violations linked to TBML schemes.

- DOJ: the Drug Enforcement Administration (DEA) and the Federal Bureau of Investigation (FBI) both conduct investigations of criminals and criminal organizations that may be involved with money laundering. The DEA is single mission; i.e. narcotics trafficking. The FBI is involved with both domestic intelligence/counter-intelligence and law enforcement. Although both the DEA and FBI can be involved with TBML-related investigations, neither organization has expertise or training in trade or data related to trade. This is because in the U.S., much of the relevant trade data that matters is held by Homeland Security. (The Department of Commerce and the Census Bureau also collects some trade data.) DHS was created in 2002. In addition, the DOJ Criminal Division's Money Laundering and Asset Recovery Section and U.S. Attorney's Offices throughout the country prosecute cases involving money laundering crimes, including TBML schemes.
- State Department: State's Bureau of International Narcotics and Law Enforcement Affairs (INL) does not have investigative authority. INL leads State's international AML technical assistance efforts. In this role, INL works in global and regional forums to promote the implementation of international AML standards. INL also funds AML assistance programs in countries around the world. Finally, INL publishes the annual International Narcotics Control Strategy Report (INCSR), which includes an analysis of countries identified as "major money laundering countries." In addition to INL, State's Bureau of Economic and Business Affairs and Bureau of Counterterrorism also play a role in State's AML/CFT efforts.
- Treasury: Treasury's Financial Crimes Enforcement Network (FinCEN) is the Financial Intelligence Unit (FIU) of the United States. FinCEN collects, analyzes, and disseminates financial intelligence pursuant to the *Bank Secrecy Act (BSA)* 31 USC 5311 et seq. In fiscal year 2019, more than 20 million BSA reports were filed by more than 97,000 U.S. financial institutions.,<sup>vi</sup> including approximately 2.3 million Suspicious

Activity Reports (SARs).<sup>vii</sup> FinCEN's original mission was to help support law enforcement in their efforts to combat financial crime, including money laundering. Increasingly, FinCEN has more of a regulatory focus. FinCEN is responsible for administering the *Bank Secrecy Act* and coordinating with federal and state regulatory agencies on AML/CFT efforts. A number of other Treasury agencies and offices also play a role in efforts to combat money laundering, including TBML. For example, Treasury's Office of Technical Assistance (OTA) provides assistance to partner countries to help strengthen their efforts to combat economic crimes. Treasury's Office of Terrorist Financing and Financial Crimes is the policy coordination office for illicit finance and develops and implements U.S. government strategies to combat all forms of illicit finance domestically and internationally. The Internal Revenue Service (IRS) Criminal Investigation investigates tax crimes and other financial crimes, including those associated with TBML schemes.

Federal financial regulators also play a role in combating money laundering by conducting examinations of financial institutions to ensure these institutions' compliance with the *Bank Secrecy Act* and its implementing regulations. These federal financial regulators include the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Securities and Exchange Commission, and the Commodity Futures Trading Commission.

Federal law enforcement officers investigating money laundering and other crimes work closely with state and local police forces. According to the 2016 FATF MER of the United States, "Law enforcement efforts rest on a well-established task force environment which enables the pooling of expertise from a wide range of law enforcement agencies (LEAs), including prosecutors, to support quality ML/TF investigation and prosecution outcomes. Overall, LEAs have access to a wide range of financial intelligence, capabilities and expertise allowing them to trace assets, identify targets and undertake expert financial ML/TF investigations. There is a strong focus on following the money in predicate offence investigations at the Federal level. There is, however, no uniform approach to State-level AML efforts and it is not clear that all states give ML due priority."<sup>viii</sup> Note: The United States

specifies particular offences as predicate offences to ML, rather than using all serious crime. It therefore lists hundreds of predicate offenses or “specified unlawful activities” for money laundering. The international standard, as championed by the FATF, is “all serious crimes.”

I address the efficacy of the United States AML regime in detail in my book, *Money Laundering and Illicit Financial Flows: Following the Money and Value Trails*, (2020 Amazon KDP). It is a lengthy subject and even a full summary is beyond the scope of this tasking question.

U.S. law enforcement has consistently talked about the importance of “following the money” and taking away the proceeds of crime from criminals and criminal organizations. Yet, for the United States and most countries including Canada, the primary investigative focus is not the money but the participants and/or the illegal product. Insofar as that is the approach, the United States does that as well as anybody.

The reality is that law enforcement focuses on the participants and the product because it is far easier than going after the money. And the product is not just illegal drugs. It similarly holds true for human beings in trafficking networks, counterfeit goods, stolen cars, weapons smuggling, illicit tobacco, wildlife trafficking, etc. It should be obvious - but many forget - that criminals do not traffic in drugs for the sake of drugs or any other illegal good or service. They engage in crime for the money. Our emphasis on product and participants has led to AML failure. In order to change that paradigm, we need to truly, finally emphasize money. In order to do that, we have to change the incentives and the culture of the bureaucracies.

The United States has the world’s most effective 20<sup>th</sup> century AML regime. In my opinion, it is expensive and extensive, but for the most part remains unequipped to deal with 21<sup>st</sup> century money laundering and illicit financial flows, including TBML. I base my critique on 30 years of experience as well as examining the “metrics that matter” regarding AML enforcement: forfeitures and convictions.

The total amount of money laundered in the United States is conservatively estimated in the hundreds of billions of dollars every year. The U.S. Treasury National Money Laundering Risk Assessment of 2015 estimates the amount of money laundered in the United States at approximately \$300 billion but also acknowledges little certainty.<sup>ix</sup> (Note: Unless I specifically

refer to Canadian dollars – CAD – all \$ totals in this report refer to U.S. dollars). Fraud and drug trafficking comprise the majority of the illicit proceeds. I personally believe the total approaches close to \$1 trillion or more annually.<sup>x</sup> Of course, it depends on what is included in the count. For example, tax evasion is not yet a specified unlawful activity for money laundering in the U.S., unlike many other countries. The U.S. has never systematically examined TBML, but academic evidence suggests trade fraud in all its many forms could be in the hundreds of billions of dollars a year.<sup>xi</sup> As far as I can tell, that also is not included in the \$300 billion estimate.

While the magnitude of money laundering in the United States (and elsewhere) is difficult to measure, we do have some statistics regarding how much illicit money is seized and forfeited. In 2014, the U.S. “confiscated” approximately \$4.4 billion.<sup>xii</sup> While this sounds like an impressive total, it is not certain what percentage was actually forfeited instead of ultimately released. Let us approximate \$3 billion. If we use the above \$300 billion estimate of the amount of money annually laundered in the U.S. every year, (I believe the total is much higher), that means the U.S. recovers less than 1 percent of the illicit money generated by criminal activity every year.

Another way of looking at the above is by examining the cost to industry of AML/CFT compliance. According to the “2019 True Cost of AML Compliance report for the United States,” the cost of compliance across U.S. and Canadian financial services firms is approximately \$31.5 billion per year.<sup>xiii</sup> That does not include the staggering AML costs borne by the government. In other words, spending on AML by both industry and government is a factor far in excess than what is recovered.

The other important metric is convictions. I believe that the United States has the best and most robust intelligence, law enforcement, and customs services in the world. Yet dated information suggests that, in the United States, money launderers face a less than five percent risk of conviction (some plead to lesser charges). Currently, there are about 1,200 money laundering convictions annually at the federal level.<sup>xiv</sup> That seems like a large number, but – divided into the amount of criminal activity and factoring in the multi-hundreds of billions of illicit proceeds generated – it is not. While the numbers are not publicly available, I believe the great majority of those convictions deal with low-level money couriers.

Referring to the above, Raymond Baker, a longtime financial crime expert and the Founding President of Global Financial Integrity, stated, “Total failure is just a decimal point away.”<sup>xv</sup> Similarly, according to a 2019 policy analysis of Canadian AML measures, Canada is likely missing 99.9 percent of money laundering.<sup>xvi</sup> Examining the data demonstrates the problem and the challenge.

## **Trade-Based Money Laundering**

In the years prior and immediately post September 11, the U.S. government and the international community had not focused attention or resources on the misuse of international trade to launder money, transfer value, avoid taxes, commit commercial fraud, and finance terror. Our adversaries – terrorists, criminals, kleptocrats, and fraudsters – were operating in these areas with almost total impunity. The trade-based methodologies almost completely avoided detection by our traditional FATF-centric AML/CFT countermeasures. And unfortunately, many years later and after the tremendous expenditure of resources to counter illicit finance, trade-based money laundering and value transfer are still not recognized as significant threats. Perhaps it is because the subterfuges are hiding in plain sight.

The FATF has declared that there are three broad categories of hiding illicit funds and introducing them into the formal economy. The first is via the use of financial institutions; the second is to physically smuggle bulk cash from one country or jurisdiction to another; and the third is the transfer of value via trade aka TBML.<sup>xvii</sup> The international community has devoted attention, countermeasures, and resources to the first two categories. In my opinion, TBML is the largest money laundering methodology. However, for the most part it has been ignored.

## **Definition of TBML**

The FATF defines TBML as “the process of disguising the proceeds of crime and moving *value* through the use of trade transactions in an attempt to legitimize their illicit origins.”<sup>xviii</sup> The key word in the definition is *value*. Instead of following the money trail via bulk cash or the electronic bits and bytes of a bank-to-bank wire transfer, with TBML we examine the shipments of commodities and trade goods. Their sale and transfer – real and fictitious – can launder money, evade taxes and tariffs, and transfer value between cooperating parties in the transaction(s).

## Magnitude of the Problem

There are no known official estimates of the global or country-specific magnitude of TBML. Since the issue impacts national security, the integrity of the global financial system, law enforcement, and the collection of national revenue, it is remarkable that TBML has never been systematically examined. As a result, there are few available metrics. And as with other topics involving money laundering, the magnitude of TBML depends on what is included in the count. Nevertheless, the following few examples are staggering.

According to the World Trade Organization (WTO), the amount of global merchandise trade varies annually but averages approximately \$20 trillion.<sup>xix</sup> The U.S. Department of the Treasury notes that TBML is one of the most challenging forms of money laundering to investigate because of the sheer volume of international trade and the complexities of trade transactions.<sup>xx</sup> In “traditional” money laundering, money launderers mix or “co-mingle” illicit funds with the by-far overwhelming percentage of legitimate money sloshing around and through the world’s financial institutions. The same holds true with international trade. It is very easy to hide the occasional suspect, illicit, or fraudulent trade transaction in the tens of trillions of dollars of annual global merchandise trade.

According to Raymond Baker, a worldwide authority on financial crime and Founding President of Global Financial Integrity (GFI), “Trade mis-invoicing – a prevalent form of TBML – accounts for nearly 80 percent of all illicit financial outflows (IFFs) that can be measured by using available data.”<sup>xxi</sup>

A GFI report notes that global traders “deliberately falsify the stated prices on invoices for goods they are importing and exporting as a way to illicitly transfer value across international borders...” It may be done to evade taxes, launder money, avoid currency controls or hide profits offshore. GFI estimates a total of \$8.7 trillion has disappeared via trade between 135 developing and 36 developed countries between the years 2008 – 2017. Approximately \$818 billion occurred in 2017 with trends currently approaching \$1 trillion a year.<sup>xxii</sup>

I understand that Dr. John Zdanowicz, an academic and early pioneer in the field of TBML, will be providing analysis for the Cullen Commission. I have the utmost respect for Dr. Zdanowicz and greatly admire his work. He generously provided me insightful analysis for my

book, *Trade-based Money Laundering: The Next Frontier in International Money Laundering Enforcement*, Wiley, 2016. As far as I know, Dr. Zdanowicz is one of the few scholars that analyzes trade data for potential trade mis-invoicing. He also calculates percentages of suspect imports and exports. For example, examining 2017 data, Dr. Zdanowicz found that nearly \$400 billion was moved into the U.S. via over-valued exports and under-valued imports. Approximately \$250 billion was moved out of the U.S. via undervalued exports and over-valued imports, representing about 6 to 9 percent of U.S. trade.<sup>xxiii</sup>

Primarily because of resources, data, technology, and advanced analytics, the United States has the most professional and vigorous customs enforcement service in the world. So, if almost 6 to 9 percent of U.S. trade is tainted by possible customs fraud and perhaps trade-based money laundering, what does that mean for the rest of the world, in particular developing countries with limited resources, weak governance, little enforcement, and high corruption?

If we extrapolate the above globally using a fair estimate that 10 percent of worldwide trade is infected with customs fraud (in many countries it is many multiples of that), using the above WTO estimate that means there is about \$2 trillion in trade fraud annually. And that number is only based on customs fraud. TBML is much more than that.

## **A Variety of TBML Threats**

TBML is found in every country in the world – both developed and developing. But the massive transfer of wealth offshore through abusive trade mis-invoicing is particularly harmful to countries with weak economies, high levels of corruption, and little adherence to the rule of law. The developmental, human and societal costs are staggering.

Illicit financial flows (IFFs) is defined by the World Bank as the “cross-border movement of capital associated with illegal activity or more explicitly, money that is illegally earned, transferred or used that crosses borders.”<sup>xxiv</sup> In economics, IFFs are generally considered a form of illegal capital flight. Capital flight occurs when money (and value) leaves primarily developing countries. Traditional thought is the onus to solve the problem is on the developing country or the country exporting the capital. The study of IFFs makes the case that the country that receives or imports the capital is also involved and bears responsibility. Trade mis-invoicing is the major component of IFFs.<sup>xxv</sup>

IFFs have a destabilizing impact on governments and society. Individuals suffer. IFFs nurture corruption, undermine governance, and reduce tax revenues. Some of the crimes behind the illicit flows of cash undermine economies, destroy the environment, and jeopardize the health and well-being of the public. Other negative consequences of IFFs include:

- Delayed development
- Promoted unemployment
- Diversion of scarce resources
- Fostering unfair competition
- Abrogating the rule of law
- Catalyzing social and political instability and unrest
- Exacerbating societal rivalries and competition between the haves and the have-nots.

Trade-based value transfer has existed long before the advent of modern “Western” banking. In some areas of the world, trade-based value transfer is part of a way of life. It is part of the culture; a way of doing business.

We are not discussing threat finance but TBML does play a role.<sup>xxvi</sup> For example, TBML is intertwined with the misuse of the Afghan Transit Trade, Iran/Dubai commercial connections, the Tri-Border region in South America, suspect international Lebanese/Hezbollah trading syndicates, non-banked lawless regimes such those in Somalia and Libya, contested territory in parts of Syria and Iraq, Iranian sanctions busting, to name a few examples. Historically and culturally trade-based value transfer is also used in “counter-valuation” between hawaladars – an alternative remittance system unfortunately linked to terrorists. We will discuss “counter-valuation” in more detail below during a discussion of the Chinese-centric alternative remittance systems known as “flying money.”

By examining other forms of TBML, the magnitude of the problem increases further. For example, TBML is also involved with customs fraud, tax evasion, export incentive fraud, VAT/carousel fraud, capital flight or the transfer of wealth offshore, evading capital controls, barter trade, underground financial systems such hawala and fei-chien, the black market peso

exchange (BMPE), and even what I call “commercial” TBML such as transfer pricing and abusive trade-mis-invoicing.

Including all its varied forms, I believe the argument can be made that TBML and value transfer is the largest and most pervasive money laundering methodology in the world. Conversely, it is also the least understood, recognized, and enforced. In comparison to the trillions of dollars in international general merchandise trade, successful TBML enforcement efforts are practically nil.

### **How Does TBML Work?**

In its primary form, TBML revolves around invoice fraud and associated manipulation of supporting documents. When a buyer and seller work together, the price of goods (or services) can be whatever the parties want it to be. There are no invoice police. As Raymond Baker, founding President of Global Financial Integrity, succinctly notes, “Anything that can be priced can be mispriced. False pricing is done every day, in every country, on a large percentage of import and export transactions. This is the most commonly used technique for generating and transferring dirty money.”<sup>xxvii</sup>

Trade-based money laundering often involves varied and sometimes elaborate schemes employed by fraudsters and criminal organizations to ensure their trades appear legitimate or unsuspecting. It is important to understand that the primary techniques involve invoice fraud and manipulation. They include:

- Over-and-under invoicing of goods and services
- Multiple invoicing of goods and services
- Falsely described goods and services

Other common techniques related to the above include:

- Short shipping: this occurs when the exporter ships fewer goods than the invoiced quantity of goods thus misrepresenting the true value of the goods in the documentation. The effect of this technique is similar to over invoicing.
- Over shipping: the exporter ships more goods than what is invoiced thus misrepresenting the true value of the goods in the documentation. The effect is similar to under invoicing.

- Phantom shipping: No goods are actually shipped. The fraudulent documentation generated is used to justify payment abroad.

## **Invoice Fraud**

Money laundering and value transfer through the over- and-under invoicing of goods and services is a common practice around the world. The key element of this technique is the misrepresentation of trade goods to transfer value between the importer and exporter or settle debts/balance accounts between the trading parties. The shipment (real or fictitious) of goods and the accompanying documentation provide cover for the transfer of money. Or sometimes the goods themselves are the transfer of value. Invoice fraud is generally considered customs fraud.

### **HERE**

What are the most common invoice scams? First, by under-invoicing goods below their fair market price, an exporter is able to transfer value to an importer while avoiding the scrutiny associated with more direct forms of money transfer. The value the importer receives when selling (directly or indirectly) the goods on the open market is considerably greater than the amount he or she paid the exporter.

For example, Company A located in Canada ships one million widgets worth \$2 each to Company B based in Mexico. On the invoice, however, Company A lists the widgets at a price of only \$1 each, and the Mexican importer pays the Canadian exporter only \$1 million for them. Thus, extra value has been transferred to Mexico, where the importer can sell (directly or indirectly) the widgets on the open market for a total of \$2 million. The Mexican company then has several options: it can keep the profits; transfer some of them to a bank account outside the country where the proceeds can be further laundered via layering and integration; share the proceeds with the Canadian exporter (depending on the nature of their relationship); or even transfer them to a criminal organization that may be the hidden actor behind the business transactions.

To transfer value in the opposite direction, an exporter can over-invoice goods above their fair market price. In this manner, the exporter receives value from the importer because the latter's payment is higher than the goods' actual value on the open market.

### **Invoice Manipulation Made Simple**

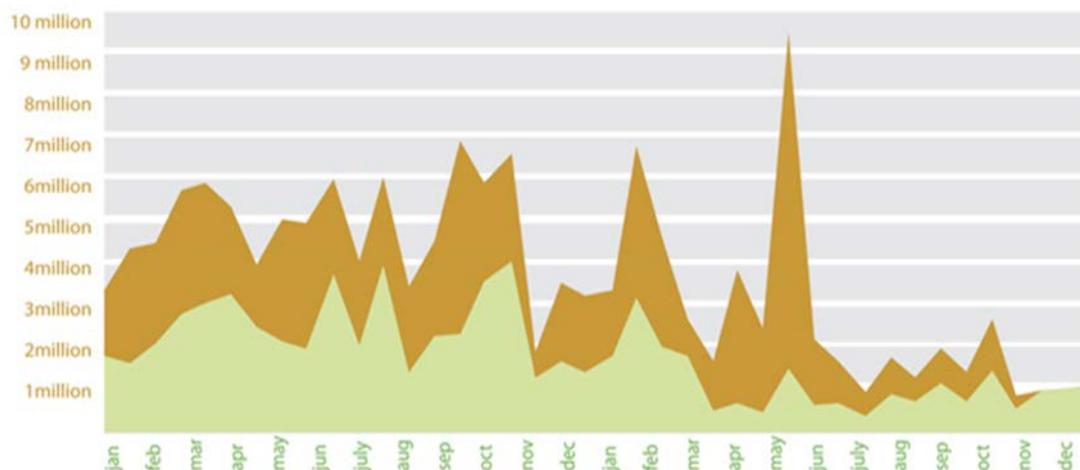
To move money/value out:

- Import goods at overvalued prices or export goods at undervalued prices

To move money/value in:

- Import goods at undervalued prices or export goods at over-valued prices

For example, Figure 1 below shows the fluctuating value associated with thousands of refrigerators exported from Country A to Country B via a series of shipments. The darker shade represents the declared value of the refrigerators upon export from Country A, and the light shade represents their declared value upon arrival in Country B. The horizontal line represents the time period over which these shipments occurred. The vertical line represents the value expressed in dollars. In this case the refrigerators were over-invoiced. The export data came from the "shippers export declaration" (SED) that accompanies the shipments. The import data came from the importing country's customs service. Obviously, the declared export price should match the declared import price. (There are some recognized but comparatively small pricing variables. In addition, the quantity and quality of refrigerators should also match – which occurred in this case.) The difference in price between the dark and light shades represents the transfer of value from the importer to the exporter. In this case, the transfer represented the proceeds of narcotics trafficking.



**Figure 1**

At the end of the graph the shaded colors start to converge. The colors or values between imports and exports begin to match because data was compared, anomalies noted, and joint enforcement action taken by the two countries involved. Trade transparency was achieved. The comparative stability at the end of the chart reflects true market conditions.

There are incredible examples of trade-mispricing. For example, Dr. John Zdanowicz conducted a study analyzing U.S. trade data.<sup>xxviii</sup> He found plastic buckets from the Czech Republic imported with the declared price of \$972 per bucket. Toilet tissue from China is imported at the price of over \$4,000 per kilogram. Bulldozers are being shipped to Colombia at \$1.74 each. Of course, there are various reasons why the prices could be abnormal. For example, there could simply be data “input” or a “classification” error. However, recalling the above explanation of over-and-under invoicing, the abnormal prices could also represent attempts to transfer value in or out of the United States in the form of trade goods. At the very least, the prices should be considered suspicious. Only analysis and investigation will reveal the true reasons for such large discrepancies between market price and declared price. Unfortunately, that rarely occurs.

Trade mis-invoicing is widespread. According to GFI's Raymond Baker, "The practice of trade mis-invoicing has become normalized in many categories of international trade. It is a major contributor to poverty, inequality, and insecurity in emerging market and developing economies. The social cost attendant to trade mis-invoicing undermines sustainable growth in living standards and exacerbates inequities and social divisions."<sup>xxix</sup>

TBML should be a tremendous global concern. Including all its varied forms, I believe it is the largest money laundering methodology in the world. Yet over the last thirty years the AML/CFT community has concentrated countermeasures almost exclusively on money laundering through financial institutions. I can say with absolute certainty that until we systematically focus on TBML our overall AML/CFT efforts will continue to fail.

### **Service-based Money Laundering (SBML)**

Service-based money laundering is almost unknown in anti-laundering enforcement. Like TBML, SBML revolves around invoice fraud and manipulation. But instead of laundering money or transferring value through trade goods, services are used. Common service-based laundering scams include accounting, legal, marketing, and natural resource exploration fees. Fraudulent construction costs, such as the mafia uses in Italy or those uncovered in Brazil's "Operation Car Wash" that spotlighted official corruption, is a common tactic.<sup>xxx</sup> Software development, marketing surveys, professional fees, consulting, product promotion, etc. are other common "service" ruses.

The State Department's global anti-money laundering review (the annual INCSR report) cites one example of SBML where "offshore companies send fictitious bills to a Montenegrin company (for market research, consulting, software, leasing, etc.) for the purpose of extracting money from the company's account in Montenegro so funds can be sent abroad."<sup>xxxi</sup> Fraudulent invoices generated from supposed concert promotions or other services that are difficult to quantify can be used to move illicit funds. Technical fees, such as writing computer code, add complexity to SBML schemes, and require investigators with specialized expertise.

Stopping SBML is no easy task. When investigating TBML, authorities can often track an item or a commodity, following a physical trail. For example, when a product is manufactured and sent from country A to country B, import and export data exist. Through analytics,

authorities can discover anomalies that indicate customs fraud. The world-price norm of the trade good or commodity in question can be obtained. SBML, by contrast, leaves no physical commodity trail, and the value of the service on the invoice is almost always subjective.

## **Capital Flight and Underground Finance**

While not asked specifically to address Chinese capital flight and underground financial systems, I am going to briefly explain why I think these issues are important for the Cullen Commission. They relate to TBML and other topics of concern.

According to a former Canadian Ambassador to Beijing, “China is the number one exporter of hot money to the world.”<sup>xxxii</sup> The exodus of capital has fueled worries about the Chinese economic outlook. Issues of concern include a China / U.S. trade war, the plummeting Chinese stock market, fears of a real estate bubble, suspect loans and balance sheets by Chinese banks, fear of a currency devaluation, increasing debt, the theft of state funds by Chinese officials, paltry returns on savings accounts, the Coronavirus pandemic, the deteriorating situation in Hong Kong, and social unrest. Furthermore, as the Chinese government clamps down on corruption, savvy Chinese are transferring wealth out of the country.<sup>xxxiii</sup>

From approximately 2006 - 2016, an estimated \$3.8 trillion in capital left China. Net foreign direct investment over the same period of time amounted to \$1.3 trillion, leaving the country with a net loss.<sup>xxxiv</sup> In 2019, before the Coronavirus pandemic, China’s hidden capital flight surged to a record high, suggesting that residents wanting to move money abroad are using unrecorded transactions to evade tight capital controls.<sup>xxxv</sup>

Over recent years, the Chinese government/CCP has imposed capital controls on corporations and businesses, as well as its citizens. The CCP has recently begun penalizing severe violators with jail time. Chinese citizens are restricted to sending the equivalent of approximately CAD \$67,000 per person out of the country per year. So how does capital flee China? There are a number of methods including:

- Tapping political and personal connections
- Using the transfer quotas of friends and family members to get money out of the country
- Channeling funds through gaming and junkets, particularly via Macau

- Using the special relationship with Hong Kong that serves as a financial conduit to the rest of the world
- Obtaining special financial services offered to the elites
- Trade-based value transfer
- Underground financial systems

Capital flight poses a few important questions and issues regarding illicit financial flows and money laundering:

- 1) Massive amounts of capital leave China. Is illicit money co-mingled with legitimate money?
- 2) Does China consider capital flight over the reporting threshold money laundering? If so, is that designation reciprocal in the receiving country?
- 3) For the U.S., Canada, and most other countries, receiving foreign capital is legal. In fact, it is often encouraged. However, money laundering could occur if the foreign capital includes the proceeds of crime or it is used to further criminal activity in the destination country.
- 4) While the influx of capital can be helpful, it can also distort local markets, cause inflationary pressure, act as the catalyst for social disruption, distort local markets, create undue influence, etc.

For example, similar to Canada, locales in the United States have received an influx of foreign cash that has been channeled into the purchase of real estate. A report by the U.S. National Association of Realtors found that almost 60 percent of purchases by international clients are made in cash.<sup>xxxvi</sup> According to the Association, Chinese buyers have been the top foreign buyers in the United States both in units and dollar volume of residential housing for six years straight. There is also an increasing amount of investment interest by middle class Chinese buyers. California is a favorite market for Chinese buyers as are Texas, Georgia and Florida.<sup>xxxvii</sup> In the United States, there is little if any customer due diligence by real estate agents. U.S. real estate agents are exempted from reporting suspicious transactions. It is not a

coincidence that in 2019, the real estate lobby in the United States spent nearly \$90 million dollars. There are nearly 600 registered real estate lobbyists.<sup>xxxviii</sup>

The “Vancouver model of money laundering,” is where large amounts of money are taken out of China through informal value transfer systems and other means to avoid China's limits on money leaving the country. Once in British Columbia, the funds are sometimes mixed with cash from the drug trade and perhaps other illicit proceeds of crime, and then the cash is cleaned through B.C. casinos and private mortgages.

The Vancouver model thus involves capital flight, TBML, underground financial systems such as “flying money,” and money laundering via real estate<sup>xxxix</sup> and other means.

According to the 2008 FATF MER of China, there are four primary means of laundering money: 1) via banks; 2) via bulk cash; 3) “Proceeds are transferred by importing or exporting over/under priced goods, or falsifying/counterfeiting import/export contracts, shipment bills, customs declarations and other related documents” (i.e. TBML); and 4) “Money is laundered through the underground banking system.”<sup>xl</sup> Points 3 and 4 are intertwined because invoice manipulation and trade fraud are commonly used in underground finance. (The above was not discussed in the recent 2019 FATF MER of China and that undermines its credibility).

Alternative remittance systems (ARS) are sometimes also called “underground banking,” “parallel banking,” or “informal value transfer systems.” Occasionally everything is erroneously labeled “hawala” - an ARS found throughout the world with origins in the Middle East and South Asia. These informal channels operate outside of the ironically labeled “traditional” channels. It’s ironic because for most of the migrants involved, the alternatives to Western-style or formal remittances are very traditional for them.

The following is a partial list of worldwide underground remittance systems. The names vary based on a number of factors including geographical locations and ethnic groups:

- Hawala – India, Afghanistan, Africa, the Middle East, Gulf, parts of the Americas
- Hundi – Pakistan, Bangladesh
- Undiyal – Sri Lanka
- Havaleh – Iran

- Door-to-door/padala – the Philippines
- Black market currency exchanges – Nigeria, South America, Iran
- Stash houses/casas de cambio – Latin America
- Phoei kuan – Thailand (Teochew Chinese)
- Hui kuan – China – (Mandarin Chinese)
- Fei-chien – “flying money,” China
- Ch’iao hui – overseas remittances – (Mandarin Chinese)
- Chop shop – foreigners sometimes use this term to describe a Chinese system
- Chiti-banking – refers to the “chit” used for receipt or proof of claim in transactions; introduced by the British in China

The two largest underground remittance systems are hawala (and its various sister systems such as hundi and undiyal) and the Chinese fei-chien or “flying money” (and related schemes). They are both global in scope. While there are no reliable estimates as to the magnitude of these two informal remittance systems, both are probably responsible for hundreds of billions of dollars in unregulated (and non-taxed) money transfers a year.<sup>xli</sup> All of these systems operate in the same general way (described below). Another common denominator is that historically and culturally most of these underground financial systems or ARS use trade-based value transfer as a mechanism to settle accounts or balance the books between brokers.

Chinese underground financial methods or alternative remittance systems are primarily used to remit wages from the Chinese diaspora back to the homeland. Of course, authorities have no wish to interfere with hard working immigrants sending money back to their home country to help support family. On the other hand, unfortunately, these low-cost and efficient financial systems and networks are also abused by criminals to move, transfer, and launder illicit proceeds. They are attractive because by their very nature they are opaque. Underground financial systems avoid government scrutiny, taxes, and countermeasures such as the filing of financial intelligence.

It is believed that fei-chien, sometimes known as “flying money,” was invented during the T’ang Dynasty (618-907 AD). At the time, there was a growing commodity trade within China. Some historians believe it was the rice and tea trades that were the catalysts for the new

financial system<sup>xlii</sup>. Ironically, as opposed to modern day practice, the transfer schemes were not invented as an underground method of evading the grasp of authorities but rather as a tool by the government to facilitate taxation.

Over the centuries, the system continued to evolve. Chinese workers increasingly began to migrate to other provinces and then overseas. Their families back home needed financial support. Expatriate Chinese businesses began to develop side businesses of remitting money back to China. The international Chinese diaspora spread the indigenous financial system further still. Today, modern Chinese businesses as well as “Chinatowns” and “China shops” are found around the world. So is flying money.

Strong Chinese family bonds are incorporated into “guanxi,” which is an overarching social system of rules that govern relationships and social behavior. Guanxi is the guarantor of both secrecy and the integrity of the parties to the transaction. Those who violate its prescriptions find themselves a social outcast, essentially shunned in all circles. Guanxi is an integral component of fei-chien. In other words, similar to hawala and other indigenous informal value transfer systems, an essential element of fei-chien is trust.

It is very difficult for law enforcement to penetrate the underground financial networks. I doubt that Canadian law enforcement, intelligence, or customs understand the relationship between Chinese underground finance and trade-based value transfer or have been tasked to collect intelligence and/or conduct investigations.

I am going to use a hypothetical example to illustrate how flying money and TBML overlap and how it impacts British Columbia. Wang in Guangdong province wants to send 500,000 Chinese yuan renminbi RMB to his brother in Victoria, BC. (We will assume in this example that the money is from legitimate sources. The funds just as easily could be from the proceeds of criminal activity). Wang wants to protect his hard-earned money by investing in Canadian dollars and Canada. It is capital flight. Wang gives a Guangdong “flying money” broker the RMB and in turn receives a code number. He trusts the broker as they have a familial relationship. The “flying money” broker in Guangdong directs his counterpart in Victoria (perhaps a member of the same family) to pay the equivalent in Canadian dollars (approximately CAD \$92,000) – less small commissions at both ends - upon presentation of the code. The code

could be transferred in a telephone call or a message contained in an e-mail or, for example, the Chinese messaging system, WeChat. Upon receipt, the Victoria “flying money” broker pays Wang’s brother. The money did not physically leave China. The money paid was Canadian dollars controlled by the Victoria flying money broker.

Money and value are also sent back to China. Like all immigrant groups, Chinese send money back home to help support their families. The same brokers are involved. Even though “flying money” largely operates on trust, family, clan and community ties, the brokers are in business to make money. Occasionally they have to settle accounts. Transactions go both directions. Using the above example, the Victoria broker might be running a deficit or a surplus with his counterpart in Guangdong. Various methods are used to settle accounts including banks, cash couriers, online payment services, and trade-based value transfer.

Surplus credits could also be used by a client unrelated to the original transaction/s. For example, credits could be used for the purchase of Victoria real estate. For a fee, the client that wants money outside China pays RMB in China to a “flying money broker” and receives credit in the desired foreign location in local currency.

Another popular method of getting RMB out of China involves finding a foreign contact who would like to set up a private exchange for Chinese yuan. “Flying money” networks are sometimes used but so are informal personal networks and business associates. For instance, a person in Victoria puts their dollars into an account in Hong Kong belonging to the Chinese individual that wants money out of the country. The Chinese individual in China puts the equivalent in Chinese yuan into an account in China that is connected with the Victoria based investor who wants the money in China.

What is often overlooked is that trade continues to be involved with the settling of accounts. This little understood concept was identified in the FATF mutual evaluation of China quoted above. Most “flying money” brokers are directly involved or associated with trading companies. As described earlier, invoice fraud and manipulation are employed - particularly over-and-under invoicing.

For example, a Chinese criminal gang based in British Columbia wants to send illicit proceeds back to China. Working with an intermediary, Chinese manufactured goods are sent to

British Columbia. The goods are over-invoiced. Payment is made for the trade goods and the extra funds (over-invoiced) represent illicit proceeds laundered. Customs and law enforcement officials are hard pressed to recognize or counter this type of scheme.

How do the “flying money” brokers profit? Although commissions are paid to the brokers at both ends of the transaction, the commissions are less than banks or traditional money remitters such as Western Union charge. In comparison to large brick-and-mortar banks and money transfer chains, expenses are small. The brokers use legitimate businesses as fronts such as restaurants, “China shops,” and trading companies. Of course, in the underground remittance segment of their business they skirt regulations and taxes. In the United States, the flying money brokers are technically classified as a money service business for the purposes of registration, licensing, and reporting financial intelligence. They do not comply and it is rarely enforced.

## **Trade Finance**

The physical shipment of trade goods involves the purchaser and the seller, but can also include many more parties to the transaction, including shipping companies, insurance companies, port and terminal operators, freight forwarders, and customs agents in both the exporting and importing countries. The financial component involves the purchaser and seller and their respective financial institutions, and the payment for the transaction is settled on agreed-upon terms. This component is generally called “trade finance.” See the Wolfsberg Group’s *Trade Finance Principles* for more details.<sup>xliii</sup>

Transactions in which a bank provides some form of financing to a party in the transaction, such as a letter of credit, are referred to as “documentary transactions.” In these transactions, banks generally process documentation involved in the trade transaction, such as the bill of lading, invoice, or packing list. The trade finance officer in the bank reviews the information underlying the transaction for soundness. The document review is undertaken to verify the trustworthiness of the transaction and also see if there are any red flags or indicators of money laundering. See Appendix 1 for a list of red flag indicators. If something suspicious is uncovered, the concerned financial institution may forward a Suspicious Activity Report (SAR) to Treasury’s Financial Crimes Enforcement Network (FinCEN). The same procedure holds true in Canada. Trade transactions involving trade finance that are deemed suspicious are forwarded

by financial institutions to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC).

However, there is a gaping hole in U.S. SAR reporting covering TBML. FinCEN data found financial institutions had filed 7,044 SARs related to TBML from 2014 to 2018, including 1,673 in 2018. While that is a substantial number, FinCEN officials also noted that the number of TBML-related trade finance SARs is a very small portion of the total of 9.6 million SARs it received over the same period.<sup>xliv</sup> To the best of my knowledge, FINTRAC has not published similar data for Canada.

One of the primary vulnerabilities of financial and trade systems is “open account trade,” in which the transaction is not financed by a bank. In open-account trade, the financial transaction between the buyer and seller—which underpins the trade transaction—is usually processed through a bank’s automatic payment systems. There is no human review or intervention. As a result, the financial institution has limited visibility into the underlying reason for the payment.

According to the Wolfsberg Group, 80 percent of international trade that is processed through financial institutions is open-account trade.<sup>xlv</sup> Banks generally do not review documentation such as invoices, bills of lading, or customs. Financial institutions generally apply standard automated AML compliance processes and procedures, including sanctions screening, when processing payments for open account trade transactions. Thus, a bank’s ability to recognize indications of possible TBML is limited for open-account transactions.

## **Countermeasures and U.S. Approach to Fighting TBML**

After the events surrounding September 11, I was concerned about how the U.S. government was fighting the war against terror finance. The USG was spending an incredible amount of resources looking in many of the wrong places for terrorist assets while almost ignoring indigenous methods terrorists and their facilitators used to launder money, transfer value, and finance terror. Many of these revolved around trade. I was convinced trade could be a “back door” into some of the underground financial networks.

In 2004, the United States government adopted a proposal I advanced. Homeland Security Investigations (HSI) created the world's first trade transparency unit (TTU).<sup>xlvi</sup> The initiative seeks to identify global TBML trends and conduct ongoing analysis of trade data provided through partnerships with other countries. We have learned that one of the most effective ways to identify instances and patterns of TBML is through the exchange and subsequent analysis of trade data. Anomalies can often be spotted by examining both sides of a trade transaction - resulting in "trade transparency."

A TTU is formed when HSI and a United States trading partner agree to formalize the exchange of trade data for the purpose of data identification, comparison and analysis. The goal is trade transparency. The prerequisite for the TTU agreement is a "customs-to-customs" agreement, treaty, or memorandum of understanding.

The wonderful thing about the TTU initiative is that the data already exists. There is no need for vast new expenditures or to struggle through labyrinths of bureaucratic hoops and approvals. Every country in the world has a customs service and already collects import and export data and associated information. Moreover, there has been an explosion of commercially available trade data over the last few years (see below). To help analyze the data, HSI has developed specialized software called the Data Analysis and Research for Trade Transparency System (DARTTS). Analysts and agents use DARTTS to examine trade and other data to generate leads for HSI investigations. DARTTS incorporates trade data (U.S. imports and exports) reported to Customs and Border Protection (CBP) and financial data (such as SARs and CTRs) reported to FinCEN. The TTU also receives and disseminates targeted import and export data from its counterparts in partner countries. The system allows users to see both sides of a trade transaction or a series of trade transactions at a macro level, making it transparent to both countries. The concept is illustrated in Figure 1 previously explained above. Added value is created by overlaying financial intelligence, travel data, business registrations, and other data sets. As a result, TTUs can easily identify trade anomalies that could be indicative of customs fraud, TBML, contraband smuggling, tax evasion, and even underground finance. Once the macro anomalies have been identified, customs and law enforcement can drill down further to the micro level and identify the individual parties involved. Of course, investigations at the street and port levels are generally still required.

The TTU investigative tool has proven to be effective. As of 2015, the small TTU network seized well over \$1 billion of assets.<sup>xlvii</sup> However, the U.S. General Services Administration is currently conducting a Congressionally mandated review of the program. While all agree the TTU concept is good, there have been numerous issues with its management and implementation.<sup>xlviii</sup> The primary obstacle is that the TTU program has not been a priority for HSI.

Many countries are not interested in TBML. But they are interested in combating trade fraud because it is a revenue maker. Governments around the world are increasingly cash strapped and looking for new revenue streams. In the United States before the 1913 ratification of the 16<sup>th</sup> amendment to the U.S. Constitution that established Congress' right to establish a national income tax, the U.S. government depended on customs duties for the majority of its national revenue. The same holds true today in many countries. Income tax systems can be rife with abuse, evasion, and corruption. Hence countries are examining ways to increase customs duties and taxes. Countries express interest in trade transparency and TTUs not necessarily to combat TBML but to crack down on trade fraud and enhance revenue. In my opinion, there is nothing wrong with that motivation. In the process of identifying customs fraud and increasing revenue, authorities also gain intelligence into TBML schemes and networks. It's a win/win.

In 2020 there are 17 operational TTUs in the international network. Most are located in the Western hemisphere. Canada is not a member. There is a 1987 Memorandum of Understanding between the United States and Canada governing the exchange of primarily import data between the two countries. The data exchange occurs at the macro level. While helpful for monitoring trade, I do not believe the information being exchanged has the necessary specificity nor the requisite export information that is needed to combat TBML and value transfer. See Appendix 2 for a list of current TTUs. In the "next frontier of international money laundering enforcement,"<sup>xlix</sup> I believe a global TTU network will be created that is somewhat analogous to the Egmont Group of Financial Intelligence Units. (There are approximately 164 FIUs in the Egmont Group network).

## **Data and Technology**

We have barely scratched the surface in applying data, analytics, and technological advances to combat TBML. By using state-of-the-art data and technology, I believe international trade transparency is theoretically achievable or certainly possible at a factor many times over what we have today.

For example, in the above discussion of TTUs, we have seen that monitoring trade data and associated international information such as travel, finance, shipping, logistics, insurance, and more generate tremendous amounts of data that can be applied to promote trade transparency. Web analytics and web crawling alone can search shipping companies and customs websites to review shipment details and compare them against their corresponding documentation. Advanced analytics can also be deployed to develop unit price analysis, unit weight analysis, shipment and route analysis, international trade and country profile analysis, and relationship analysis of trade partners and ports.<sup>1</sup> And, of course, there is also classified data that could be better exploited to examine certain questionable aspects of trade and nefarious actors.

Each country has its own unique customs and other government services that track a myriad of trade, import and export data at both the macro and micro levels. This data is generally considered law enforcement/customs sensitive. It has not been disseminated in the public domain. However, over the last few years more and more trade data is being released. Trade information is developed and disseminated. Public and private sources of material have resulted in an explosion of trade data that is available – often for a fee. Much of the data is macro oriented. It is often not possible to obtain granular information such as the identifiers of individual traders and shippers. Yet sometimes through analysis that very information can be extrapolated.

Some publicly available trade data sources are the United Nations Comtrade database, Datamyne, PIERS, Import Genius, Panjiva, Tradessparq, WiserTrade, Infodrive India, and SICEX. In addition, Dr. John Zdanowicz offers International Trade Alert and Global Financial Integrity offers GFTrade for trade price anomaly detection based on world norm trade price analysis and related information.

Many experts believe that distributed ledger technology (DLT) such as block chain represents great promise in detecting and preventing trade-mis-invoicing – the biggest component of TBML. There are three possible techniques: 1) comparing invoices against each other; 2) comparing invoices against market the generally accepted market price/s; and 3) comparing values declared to customs with the values in the financial transactions.<sup>li</sup>

In the first option, customs authorities and other relevant “smart” partners could use the information available on a DLT platform comparing the invoice submitted by the exporter to the invoice submitted by the importer. The analytic platform could compare the two documents, adjusting for “cost, insurance and freight” (CIF) and “free on board” (FOB) differences. Most countries report imports on a CIF basis, whereas most exports are reported using the FOB valuation. This CIF/FOB conversion is one of the many challenges in analyzing trade data, along with transshipment and re-export complexities. The import and export invoice comparison would allow customs on both sides to identify mis-invoicing and charge the correct export or import duties. However, this comparison would not identify “same-invoice faking” where trading partners agree to report the same false value on invoices. Hence the need for the second comparison option.

So, the next option would be for customs authorities and smart partners to compare invoices against the generally accepted market price/s for that product. Global Financial Integrity’s GFTrade<sup>lii</sup> already uses this technique to compare the invoice value with what that same product is trading for, based on updated official government data from 43 countries. This allows customs authorities to identify possible trade mis-invoicing even while the shipment is still in port. Correct duties can then be levied.

A third option, if applicable, is to have DLT compare the invoices presented to customs with the values sent to the financial institutions involved in the letter of credit process. This option means that customs authorities and other partners participating in the DLT platform such customs and tax authorities could compare the letter of credit and the invoices to verify that they match. If not, payment of the correct customs duties would be required for release.

There are already prototypes for some of the above. In 2018, in the United States CBP piloted a proof-of-concept assessment to evaluate the application of blockchain technology to the

process of submitting documents for cargo entry. As noted, blockchain allows different users to make transactions and then creates an unchangeable, secure record of those transactions. DLT, including blockchain, share and verify information across many or multiple devices to increase transparency, reduce risk of tampering and remove the need for a trusted third party. The goal of the CBP assessment is to prove that a standards-based, fully digital system could be created to replace the existing paper-based system. Manual document handling is insecure, facilitates fraud, and slows logistics. Hopefully, the new technology will improve auditability, increase transparency, and more clearly identify suppliers and manufacturers, which could help better identify fraudulent documentation and assist with trade transparency.<sup>liii</sup>

In 2018, Maersk and IBM announced the creation of a new platform—TradeLens—to provide more efficient and secure methods for conducting global trade that also uses blockchain technology. The platform is intended to provide timely end-to-end supply-chain visibility for businesses and authorities along the supply chain. It will enable regulatory and customs authorities to closely monitor the flow of goods, carry out risk assessments, and perform regulatory processing in an efficient manner, thereby reducing the risk of illicit activity, including TBML. TradeLens is an interconnected ecosystem of supply chain partners — cargo owners, ocean and inland carriers, freight forwarders and logistics providers, ports and terminals, customs authorities, regulators, and more. TradeLens runs on a permission matrix and blockchain, ensuring every party to a shipment has access only to their information and a secure audit trail of all transactions.<sup>liv</sup>

The newest generation of “smart” shipping containers also hold promise in combatting TBML. Studies show that a single shipping transaction involves an average of 28 different entities including ports, forwarders, carriers and customs agencies.<sup>lv</sup> Smart containers offer real-time monitoring anywhere in the world of a container’s location, its internal conditions, and physical integrity. The new technology features access controls so each container remains sealed until the shipper authorizes the opening of each container. The data generated for each container can also provide customs agencies an additional tool to identify safe containers that qualify for expedited clearance.

While an international TTU network, increased data, robust analytics, blockchain technology, smart containers, and other countermeasures are certainly not going to solve the

diversity of TBML challenges, widespread use will definitely assist law enforcement and customs. The larger question is whether or not policy makers want to move in the direction of international trade transparency.

### **TBML Vulnerabilities in Canada and British Columbia**

I believe Canada in general and British Columbia specifically face current threats from TBML. As explained above, there are many different typologies related to TBML. I have not seen the report that is being prepared by Dr. John Zdanowicz for the Cullen Commission, but I believe his work will show that customs fraud and related invoice manipulation is serious, widespread, and results in substantial revenue loss for Canada and its provinces. Likewise, while I have seen little data or case examples (see below on why this needs to be resolved), I am also convinced that Chinese capital flight to Canada linked to trade-based value transfer merits scrutiny as does Chinese underground financial systems such as “flying money” which helps enable unregulated capital flow. Both of these typologies have been previously described.

A further TBML methodology that should concern Canadian authorities is the Black Market Peso Exchange or BMPE. The BMPE is one of the largest money laundering methodologies in the Western Hemisphere.<sup>lvi</sup> In the “traditional” BMPE model, narcotics traffickers sell at a discount the dollar proceeds of U.S. drug sales within the United States to black market peso brokers based in Mexico and Colombia. In turn, the brokers “place”<sup>lvii</sup> the illicit proceeds into the U.S. financial system and use the funds to purchase trade goods that are sent to Colombia or Mexico. No money crosses borders. Only the ownership of the currencies involved change hands. In years past, U.S. drug dollars purchased Marlboro cigarettes, Bell helicopters, U.S. manufactured electronics, etc. The company representatives or trade brokers did not know or were “willfully blind” regarding the origin of the funds used to purchase the merchandise. The same type of BMPE takes place in Europe. Illicit proceeds are used to purchase European manufactured product that is shipped to Mexico, Colombia, and other drug producing countries.

Increasingly, the purchases, logistics, foreign exchange specialists, and trade intermediaries are Chinese and Chinese organized crime groups. They arrange for drug dollar

purchase of Chinese merchandise (much of it counterfeit) to be sent to Central and South America including Colombia, Mexico, the Tri-Border area, and the Colon Free Trade Zone.

Discussing the BMPE, FINTRAC notes “brokers send suspected illicit funds held in Latin America or the U.S. to Canadian trading companies, wholesalers, dealers and brokers via electronic funds transfer and, to a limited extent, cash courier. These entities subsequently send the funds to entities in multiple jurisdictions, including China, Hong Kong and the U.S., to pay for goods.” Further, according to FINTRAC, “Brokers send suspected illicit funds held in Latin America to U.S.-based entities of varying types, as well as to China or Hong Kong-based trading companies, through electronic funds transfer via a Canadian financial institution acting as a correspondent bank.”<sup>lviii</sup>

FINTRAC analysis does not address the BMPE laundering of Canadian drug dollars in Canada. While there are few if any investigations, there is a very good probability that Canadian drug dollars are used to directly or indirectly purchase Canadian manufactured goods, commodities, and raw materials. It would also be very easy for narco-trafficking organizations to use Canadian brokers or trading companies to set up a network of anonymous shell companies in various domestic and foreign locations that assist in BMPE or BMPE-like operations. Canada does not have a central registry of beneficial ownership information. And in addition to the traditional BMPE destinations such as Columbia and Mexico, I encourage authorities to examine the origin of funds used to purchase Canadian product shipped to or routed through Venezuela and Cuba.

Another TBML methodology is the misuse of the international gold, precious metals, diamonds and gems industries. These represent large sectors of the Canadian economy – including British Columbia. Over the last 30 years, the misuse of gold, gems, and precious metals have consistently been used in countries around the world to launder staggering amounts of money. In that timeframe, some of the largest money laundering cases in history have involved gold.

In my book *Money Laundering and Illicit Financial Flows: Following the Money and Value Trails*,<sup>lix</sup> I devote a chapter on gold and explain why gold is attractive to criminals in TBML. In summary, depending on its form, gold is both a commodity and a monetary

instrument. Gold is a readily accepted medium of exchange accepted anywhere in the world. In times of uncertainty, gold offers stability. Gold offers easy anonymity to money launderers. Depending on the need, the form of gold can be easily altered. There is a worldwide market and cultural demand. Gold transactions can be easily layered or hidden. Gold, in its varied forms, can easily be smuggled and by weight represents much more value than cash. (Diamonds are the most condensed form of physical wealth in the world but the value of rough diamonds is subjective. Money launderers prefer the certainty that gold offers). Gold is often used in fraudulent TBML schemes; for example, importing gold scrap at prices higher than gold bullion. And, in parts of the world, gold is the favored commodity to use in underground financial systems such as hawala when brokers “counter-value” or balance the books in over-and-under invoicing schemes.

While there have been major investigations around the world involving the misuse of gold, precious metals, diamonds, and gems it is not clear if cases have been made in Canada. Certainly, Canada is vulnerable. Canada has all the factors that would enable gold and precious gems to be used as a money laundering mechanism. Countermeasures are known. Gold in all its many forms should be an automatic red flag for customs, law enforcement, intelligence agencies, and bank compliance officers – particularly when the sourcing, destination, or routing is problematic. Trade data for gold in almost all its forms should be collected and analyzed. Anomalies should be identified and the results disseminated. Money laundering via the misuse of the international gold trade should be prioritized simply because gold represents one of the prime risks for laundering large amounts of money or transferring large amounts of value. Also, we know that gold manufacturers and dealers should set up AML/CFT compliance programs. The challenge is that these common sense countermeasures are not sufficiently implemented.<sup>lx</sup>

## **Recommendations**

I offer the following TBML related recommendations:

- 1. Transparency in AML case statistics:** In order to determine an effective strategy against TBML, it is absolutely necessary to have straight forward and transparent investigative and case statistics at both federal and provincial levels. According to data provided by B.C.’s Ministry of the Attorney General, 50 money-laundering cases were submitted to the

BC Prosecution Service between 2002 and 2018. Only 10 individuals were found guilty. Of course, others may have been found guilty of other offences.<sup>lxi</sup> As noted on page 5 of this statement, federal money laundering conviction statistics are also disappointing. In addition to the above statistics, I urge the Cullen Commission to determine specifically how many TBML cases ever been worked in British Columbia. How many resulted in successful convictions? How many TBML related assets were seized and ultimately forfeited? How many law enforcement and other personnel have been devoted to combat TBML?

2. **How many TBML STRs have been filed?** As I note on page 26 of this report, the U.S. FinCEN released the annual compilation of TBML SAR data. FINTRAC should do the same for Canada and each of the provinces. The suspicious transaction report (STR) data will help determine if TBML compliance regarding trade-finance is effective.
3. **Create a specialized unit within the RCMP to investigate money laundering including TBML:** According to a 2019 press report, “not a single federal police officer is working to bust money launderers in B.C.”<sup>lxii</sup> If accurate, that is the crux of the problem. As I discussed earlier in this statement, AML success comes down to enforcement as measured by convictions and forfeitures. In order to be more effective in recognizing and investigating TBML in all its varied forms, the RCMP and others involved will have to change the culture of the bureaucracies.<sup>lxiii</sup> It is an often overlooked truism that criminal organizations engage in crime for the money. Yet law enforcement does not like to emphasize following the money because it is difficult and time consuming. Following the money and value trails should be prioritized. In order for that to happen, incentives for the investigators must change. Training will be required. Expertise must be developed.
4. **Create a Canadian Trade Transparency Unit (TTU):** The Canada Border Services Agency (CBSA) might explore establishing a TTU as described in pages 27 – 28 of this statement. The CBSA already collects trade data and intelligence. It conducts operational targeting. Incorporating the mission of trade transparency easily fits into its mission. The ideal would be for representatives of the CBSA, the RCMP, the Canada Revenue Agency, and FINTRAC to be co-located within the TTU. The TTU will develop investigative leads that can then be forwarded to the specialized money laundering investigative unit briefly discussed in recommendation #3 above. The establishment of a TTU will be a net

revenue gain for the government. As discussed, a systematic crackdown on trade fraud should result in fines, penalties, taxes, duties, and forfeitures. The proposed TTU could explore joining the established TTU network but it isn't essential. The important thing is to form a specialized Canadian unit that focuses on trade fraud that may be indicative of TBML and value transfer.

- 5. Explore the viability of technical solutions:** I encourage Canadian authorities to examine advanced analytic solutions, distributed ledger technology, the use of smart containers and other technical innovations. Some of these have been briefly described in this statement.
- 6. Establish a national registry of beneficial ownership information:** I understand that the BC Ministry of Finance has delayed the transparency register requirements under the Business Corporations Act until October 1, 2020. Because TBML and money laundering in general is transnational in scope, Canada as a whole should have a central/national beneficial ownership registry.
- 7. Examine Service-Based Money Laundering (SBML):** Victoria, B.C., is a thriving center for business development and economic investment and offers an incredible array of domestic and international commercial and professional services. As described in pages 18-19 of this report, I encourage authorities to keep SBML in mind when examining money laundering vulnerabilities in Victoria and British Columbia.
- 8. Create a specific FATF recommendation to counter TBML.** Within the AML/CFT community, it is the FATF that makes things happen. For many reasons, the FATF has dragged its feet regarding the creation of a separate FATF recommendation on TBML. I urge Canada and other concerned nations to have their FATF delegations introduce and push for the adoption of **FATF Recommendation #41, Countering TBML.**

## Endnotes

<sup>i</sup> Canada's Mutual Evaluation Report, September, 2016, the Financial Action Task Force; <http://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-canada-2016.html>

<sup>ii</sup> The International Narcotics Control Strategy Report (INCSR), Volume II Money Laundering, U.S. Department of State, March 2020, see Canada section page 73; <https://www.state.gov/wp-content/uploads/2019/03/INCSR-Vol-INCSR-Vol.-2-pdf.pdf>

<sup>iii</sup> Andrew Russel, "Not just B.C.: Most provinces in Canada fail to secure convictions in money-laundering cases," *Global News*, February 10, 2019; <https://globalnews.ca/news/4939801/provinces-canada-fail-to-convict-money-laundering/>

<sup>iv</sup> "Stopping Dirty Money – The Global Effective Meters," Transparency International, December 13, 2017; <https://www.transparency.org/en/news/stopping-dirty-money-the-global-effective-o-meter>

<sup>v</sup> Much of this section is taken from the report, "Trade-Based Money Laundering," Government Accountability Office, April 2020, pages 10 – 11; <https://www.gao.gov/assets/710/705679.pdf>

<sup>vi</sup> "What is the BSA Data?" FinCEN website; <https://www.fincen.gov/what-bsa-data#:~:text=In%20fiscal%20year%202019%2C%20more,other%20financial%20crimes%2C%20and%20terrorism.>

<sup>vii</sup> Dynamic Securities Analytics; <https://securitiesanalytics.com/2019-sar-insight-suspicious-activity-report-annual-analysis/#:~:text=2%2C301%2C163%20SARs%20were%20filed%20in,in%20SAR%20filings%20in%202019.>

<sup>viii</sup> Mutual Evaluation of the United States, the FATF, December 2016, page 4; <http://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-united-states-2016.html>

<sup>ix</sup> U.S. Treasury National Money Laundering Risk Assessment, U.S. Department of Treasury, 2015, page 2; <https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/National%20Money%20Laundering%20Risk%20Assessment%20%E2%80%93%2006-12-2015.pdf>

<sup>x</sup> John Cassara, *Money Laundering and Illicit Financial Flows: Following the Money and Value Trails*, Amazon/KDP, 2020; see Chapter 2 "Sobering Statistics" where I use available metrics to discuss the magnitude of money laundering both internationally and in the United States fully acknowledging the uncertainty of the estimates and debates over "what should be included in the count."

<sup>xi</sup> Data given to the author by Dr. John Zdanowicz

<sup>xii</sup> FATF MER of the United States, 2016, page 8.

<sup>xiii</sup> "Increase AML compliance efficiencies and lower costs," Lexis Nexis, 2019; <https://risk.lexisnexis.com/insights-resources/research/2019-true-cost-of-aml-compliance-study-for-united-states-and-canada>

<sup>xiv</sup> *Ibid*, page 4.

<sup>xv</sup> Raymond Baker, *Capitalism's Achilles Heel*, Wiley & Sons Publishing, Hoboken, New Jersey, 2005; page 173

<sup>xvi</sup> Jen. St. Denis, "Canada missing 99.9 per cent of money laundering because of weak rules, expert estimates," *Vancouver Star*, December 26, 2019; <https://www.thestar.com/news/canada/2019/05/06/canada-missing-999-per-cent-of-money-laundering-because-of-weak-rules-expert-estimates.html#:~:text=VANCOUVER%E2%80%94Canada%20is%20likely%20missing,Howe%20policy%20paper%20released%20Monday.>

Some of the material in this section comes from: John Cassara, *Trade-Based Money Laundering: the Next Frontier in International Money Laundering Enforcement*; Wiley, Hoboken, New Jersey, 2015. The material in the book was summarized in the author's Written Statement for the Hearing On "Trading with the Enemy: Trade-Based Money Laundering is the Growth Industry in Terror Finance" Before the Task Force to Investigate Terrorism Financing of the House Financial Services Committee, February 3, 2016;

<https://financialservices.house.gov/uploadedfiles/hhrg-114-ba00-wstate-jcassara-20160203.pdf>

<sup>xvii</sup> FATF; Trade Based Money Laundering (Paris: FATF, June 23, 2006), p. 1; <http://www.fatf-gafi.org/media/fatf/documents/reports/Trade%20Based%20Money%20Laundering.pdf>

<sup>xviii</sup> *Ibid*

<sup>xix</sup> World Trade Statistical Review 2016, World Trade Organization;

[https://www.wto.org/english/res\\_e/statis\\_e/wts2016\\_e/wts2016\\_e.pdf](https://www.wto.org/english/res_e/statis_e/wts2016_e/wts2016_e.pdf)

- <sup>xx</sup> Department of the Treasury, 2015 National Money Laundering Risk Assessment, June 2015
- <sup>xxi</sup> “The Economist Highlights the Scourge of Trade Mis-invoicing,” Global Financial Integrity, May 2, 2014; <http://www.financialtransparency.org/2014/05/02/the-economist-highlights-the-scourge-of-trade-misinvoicing/>
- <sup>xxii</sup> “Trade-Related Illicit Financial Flows in 135 Developing Countries: 2008-2017,” Global Financial Integrity, March 3, 2020; [https://gfintegrity.org/report/trade-related-illicit-financial-flows-in-135-developing-countries-2008-2017/?utm\\_content=84174486&\\_hsenc=p2ANqtz-\\_Ljm5Fw8BIDfh4e4FjwETE0neCbWhOr13SpXJyJCCp8toDKhMHx-K9B9SC8OBn5ZzUeA5x\\_YFvpSwCy6-\\_4zVkSmYoa1pUHWycbj1YTQRjpC4z7l&\\_hsmi=84174486](https://gfintegrity.org/report/trade-related-illicit-financial-flows-in-135-developing-countries-2008-2017/?utm_content=84174486&_hsenc=p2ANqtz-_Ljm5Fw8BIDfh4e4FjwETE0neCbWhOr13SpXJyJCCp8toDKhMHx-K9B9SC8OBn5ZzUeA5x_YFvpSwCy6-_4zVkSmYoa1pUHWycbj1YTQRjpC4z7l&_hsmi=84174486)
- <sup>xxiii</sup> Data given to the author by Dr. Zdanowicz.
- <sup>xxiv</sup> “Illicit Financial Flows,” The World Bank, July 7, 2017; <https://www.worldbank.org/en/topic/financialsector/brief/illicit-financial-flows-iffs>
- <sup>xxv</sup> See John Cassara, *Money Laundering and Illicit Financial Flows: Following the Money and Value Trail*, Chapter 4 on Illicit Financial Flows, Amazon KDP, 2020.
- <sup>xxvi</sup> See my testimony and written statement for the Hearing On “Trading with the Enemy: Trade-Based Money Laundering is the Growth Industry in Terror Finance” Before the Task Force to Investigate Terrorism Financing Of the House Financial Services Committee, February 3, 2016; [https://financialservices.house.gov/uploadedfiles/02.03.2016\\_john\\_a.\\_cassara\\_testimony.pdf](https://financialservices.house.gov/uploadedfiles/02.03.2016_john_a._cassara_testimony.pdf)
- <sup>xxvii</sup> Raymond W. Baker, *Capitalism’s Achilles Heel*, John Wiley & Sons, Hoboken, New Jersey, p. 134
- <sup>xxviii</sup> Dr. John Zdanowicz, *Trade-Based Money Laundering and Terrorist Financing*; <https://datapro.fiu.edu/campusedge/files/articles/zdanowiczj3008.pdf>
- <sup>xxix</sup> “Global Financial Integrity Releases New Study on Trade Misinvoicing in South Africa,” Global Financial Integrity, November 13, 2018; <https://www.gfintegrity.org/press-release/global-financial-integrity-releases-new-study-on-trade-misinvoicing-in-south-africa/>
- <sup>xxx</sup> John Cassara, “Service-Based Money Laundering: The Next Illicit Finance Frontier,” Foundation for the Defense of Democracies, May 19, 2016; <http://www.defenddemocracy.org/media-hit/john-cassara-service-based-money-laundering-the-next-illicit-finance-frontier/>
- <sup>xxxi</sup> International Narcotics Control Strategy Report, Volume II Money Laundering, March 1, 2015, see Montenegro Country Report; <https://www.state.gov/documents/organization/239329.pdf>
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- <sup>xxxiii</sup> See John Cassara, *Money Laundering*, pages 226 - 227
- <sup>xxxiv</sup> Frank R. Gunter, “Why China Lost About \$3.8 Trillion To Capital Flight In The Last Decade,” *Forbes*, February 22, 2017; <https://www.forbes.com/sites/insideasia/2017/02/22/china-capital-flight-migration/#93f4f0e4a37c>
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- <sup>xxxvii</sup> Diane Olick, “Chinese buyers expand their reach in the U.S. housing market as the middle class gets in on the act,” *CNBC*, January 8, 2019; <https://www.cnbc.com/2019/01/08/chinese-middle-class-buying-up-american-residential-real-estate.html>
- <sup>xxxviii</sup> “Real Estate Lobbying, 2019,” *Open Secrets*; <https://www.opensecrets.org/industries/lobbying.php?ind=F10++>
- <sup>xxxix</sup> For further information on money laundering via real estate please see John A. Cassara, “Money Laundering and Illicit Financial Flows: Following the Money and Value Trails,” Chapter 8 on Real Estate, 2020, Amazon Kindle.
- <sup>xl</sup> “Mutual Evaluation of China,” the FATF, 2007; <http://www.fatf-gafi.org/countries/a-c/china/documents/mutualevaluationofchina.html>
- <sup>xli</sup> See John Cassara, *Money Laundering* pages 99-100 and references. According to the World Bank, official global remittances totaled approximately \$625 billion in 2018. Because unofficial remittances are hidden, there are no reliable numbers regarding the magnitude of the problem. However, the IMF believes, “Unrecorded flows through informal channels are believed to be at least 50 percent larger than recorded flows.” Thus, using the above World Bank and IMF estimates, unofficial remittances are enormous.

- <sup>xlii</sup> Jacob Trigler, “Indicators of Informal Funds Transfer Systems; A Comparison of Traditional and Modern Systems,” Monterrey Naval Post Graduate School Thesis, page 27; <https://apps.dtic.mil/dtic/tr/fulltext/u2/a494175.pdf>
- <sup>xliii</sup> “Trade Finance Principles,” The Wolfsberg Group; <https://iccwbo.org/publication/wolfsberg-trade-finance-principles/>
- <sup>xliv</sup> “Trade-Based Money Laundering - U.S. Government Has Worked with Partners to Combat the Threat, but Could Strengthen Its Efforts,” General Accountability Office (GAO), April 2020, page 21; <https://www.gao.gov/assets/710/705679.pdf>
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- <sup>xlvi</sup> For further information see the TTU website at: <https://www.ice.gov/trade-transparency>
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- <sup>xlviii</sup> “Trade-Based Money Laundering,” GAO Report, April 2020
- <sup>xlix</sup> “The Next Frontier in International Money Laundering Enforcement” is the subtitle of my book on TBML.
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- <sup>liv</sup> Ibid. See also: <https://www.tradelens.com/>
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- <sup>lvi</sup> FinCEN Advisory, Colombian Black Market Peso Exchange, 1997; <https://www.fincen.gov/sites/default/files/shared/advisu9.pdf>
- <sup>lvii</sup> “Placing, layering, and integration” are the three stages of money laundering. There are a variety of ways to place illicit funds into the financial system. The primary method is structuring transactions under the financial intelligence reporting threshold.
- <sup>lviii</sup> “Operational alert: Professional money laundering through trade and money services businesses,” FinTRAC, July 18, 2018; <https://www.fintrac-canafe.gc.ca/intel/operation/oai-ml-eng>
- <sup>lix</sup> John A. Cassara, “Money Laundering and Illicit Financial Flows: Following the Money and Value Trails,” Chapter 10, *The Misuse of the International Gold Trade*, 2020, Amazon Kindle
- <sup>lx</sup> John Cassara, *Money Laundering*, See Chapter 10, *The Misuse of the International Gold Trade*.
- <sup>lxi</sup> Andrew Russel, “Not just B.C.: Most provinces in Canada fail to secure convictions in money-laundering cases,” Global News, February 10, 2019; <https://globalnews.ca/news/4939801/provinces-canada-fail-to-convict-money-laundering/>
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- <sup>lxiii</sup> I discuss this in some detail in my book “Money Laundering and Illicit Financial Flows.” Specifically, see Chapter 14 on “More Forward Steps; pages 316 - 318 includes sections on “Really, Truly, Finally Go After the Money” and “Change the Incentives for Law Enforcement

## **Appendix 1**

John A. Cassara, *Red Flag Indicators: Statement to the Cullen Commission of Inquiry into Money Laundering in British Columbia, 2020*

# Appendix 1

## Red Flag Indicators

TBML can be complex, confusing, and often “hiding in plain sight.” Fortunately, a number of concerned organizations have issued “red flag” indicators or warning signs that could be indicative of TBML. I have found some of the best originate from the 2006 FATF Typology Report on Trade Based Money Laundering,<sup>i</sup> the 2012 Asia Pacific Group Typology Report on Trade Based Money Laundering,<sup>ii</sup> the 2014 Federal Financial Institutions Examination Council’s Bank Secrecy Act/Anti-Money Laundering Examination Manual,<sup>iii</sup> a 2010 FinCEN Advisory to Financial Institutions on Filing Suspicious Activity Reports regarding Trade Based Money Laundering,<sup>iv</sup> and Singapore’s 2018 AML/CFT Industry Partnership Best Practices for Countering TBML.<sup>v</sup>

Many of the above referenced indicators are duplicative and/or overlap. Some also focus on different subsets of TBML, including underground financial systems, etc. Many of the red-flags deal with trade finance. In this Appendix, I include many indicators from the above cited references and add a few of my own. The red flags listed below are not in any particular order, category or priority. By combining them, I believe the Commission and a student of TBML will see the broader context and also be able to pick and choose the indicators that are of most interest.

I wish to emphasize that red flags by themselves are not proof of illegal activity. They are simply indicators that the transaction *might deserve closer scrutiny*. The concerned compliance officer, analyst, or investigator must take into consideration other factors including the normal transaction/business activity by the subject/s, the particulars of the trade item, its recognized value (which can sometimes be subjective), financing, the geographic locations involved with the transaction, a previous history of trade fraud, criminal associations, the presence of financial intelligence on any of the parties involved, and many other factors.

# Possible Red Flag Indicators of TBML

- Significant discrepancies between the description, quality, and quantity of the commodity on the bill of lading, invoice, and actual goods shipped.
- Discrepancies between the values of the commodity as reported on the invoice and the normal market value.
- The weight of the shipment does not match the listed contents.
- The shipment is inconsistent with the exporter's normal business; e.g. an exporter of consumer electronics shipping paper supplies.
- The size of the shipment appears inconsistent with the exporter's normal business activity.
- Invoices or bills of lading that include inaccurate information about the product being shipped or information that is not commonly accepted; e.g. an invoice listing the square feet of granite tile being imported is suspect because it is priced by the ton.
- Invoices that contain inaccurate or incomplete product descriptions; for example, an invoice for 1000 kilograms of frozen shrimp is not sufficient to analyze its market value because there are multiple harmonized codes for frozen shrimp reflecting imports of different sizes.
- The type of commodity is being shipped from or through areas of "high risk" for money laundering.
- Companies operating out of foreign countries where it is very difficult to determine the true ownership or controlling persons of the company or where the type of business is not fully apparent.
- A party's inability or unwillingness to produce appropriate documentation upon request.
- Documentation that appears fraudulent.
- The routing of the shipment is circuitous, not-direct, illogical or is being transshipped through a questionable area for no apparent economic reason.

- A shipment of goods destined for an end-user that has no need for the product; e.g. electronics manufacturing equipment sent to a destination that has no electronics industry.
- Shipments that involve suspect Free Trade Zones or Special Economic Zones.
- The method of payment is inconsistent with the normal business practice of the parties involved, inconsistent with the characteristics of the transaction, or using advance payment for a shipment from a new supplier in a high risk country.
- The transaction involves the receipt of cash.
- International wire transfers received as payment for goods into bank accounts where the exporter is not located.
- The transaction involves a third party that has no apparent connection to the buyer or seller.
- Payment made from multiple accounts.
- The transaction involves the use of front or shell companies.
- The parties involved are not transparent and use “Delaware”-like corporations.
- Numerous sole proprietorship businesses or private limited companies are involved in the transaction or established by proxies or where false addresses are involved.
- The transaction and payment appear to have unnecessary and complex layers involving multiple accounts and multiple jurisdictions that combine to obscure the true nature of the transaction.
- Money service businesses or money exchange bureaus located in third countries used as intermediaries for the transfer of goods or money.
- The transaction involves a frequently amended letter of credit.
- Shipment locations or description of goods are not consistent with the letter of credit.
- Transactions that involve payments for goods through checks, drafts, or money orders not drawn on the account of the entity that purchased the items.
- Unusual deposits of cash, cash deposits in round numbers or structured cash deposits under the reporting threshold into a bank account used to fund the trade transaction.
- Sequentially numbered checks drawn on domestic bank accounts negotiated through foreign money service businesses.

- A contract that is other than an “arm’s length” transaction; i.e. transfer pricing.
- Related party transactions; e.g. familial relationships.
- The use of goods that are often involved with TBML schemes such as scrap gold, precious metals and stones, trade in tobacco, consumer electronics, automobiles, etc.
- Goods that present valuation difficulties (precious stones, artwork, scrap gold, etc.)
- A freight forwarding firm listed as the commodity’s final destination.
- Goods that are frequently used in bartering schemes (gasoline and tires).
- A shipment that does not make economic sense; e.g. the use of a 40 foot shipping container to transport a relatively small volume of goods.
- Carousel transactions; the repeated or circular importation and exportation of the same high-value commodity.
- Packaging that is inconsistent with the commodity or shipping method involved.
- A manufacturing entity that upon inspection or verification has no physical address, no or limited production capability, limited or no inventory at its business premises, etc.
- Phantom shipments – No goods are actually shipped but payment (generally of illicit proceeds) is made. Confirmation of shipment and delivery should be requested in a suspect case of TBML.
- Multiple invoicing of suspect goods. A frequently repeated suspect pattern of numerous invoices involving the same or similar items and where the actual physical shipment is never physically verified.
- The exporter requests payment of proceeds to an unrelated third party.
- Padding or inflating the quantity or quality of the goods
- The use of counterfeit invoices. If an invoice looks suspicious, try to compare it with a known genuine invoice. Note any differences in the quality of the printing, different contact numbers, e-mail addresses, or other items recorded in previous correspondence.

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<sup>i</sup> 2006 FATF Typology Report on Trade Based Money Laundering; available online at (<http://www.fatf-gafi.org/media/fatf/documents/reports/Trade%20Based%20Money%20Laundering.pdf>)

<sup>ii</sup> 2012 Asia Pacific Group Typology Report on Trade Based Money Laundering; available online at ([http://www.fatf-gafi.org/media/fatf/documents/reports/Trade\\_Based\\_ML\\_APGReport.pdf](http://www.fatf-gafi.org/media/fatf/documents/reports/Trade_Based_ML_APGReport.pdf))

<sup>iii</sup> 2014 Federal Financial Institutions Examination Council's Bank Secrecy Act/Anti-Money Laundering Examination Manual; available online at ([https://www.ffiec.gov/bsa\\_aml\\_infobase/documents/BSA\\_AML\\_Man\\_2014.pdf](https://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2014.pdf))

<sup>iv</sup> 2010 FinCEN Advisory to Financial Institutions on Filing Suspicious Activity Reports regarding TBML; available online at ([http://www.fincen.gov/statutes\\_regs/guidance/pdf/fin-2010-a001.pdf](http://www.fincen.gov/statutes_regs/guidance/pdf/fin-2010-a001.pdf))

<sup>v</sup> Singapore's 2018 AML/CFT Industry Partnership Best Practices for Countering TBML; <https://www.abs.org.sg/docs/library/best-practices-for-counterering-trade-based-money-laundering.pdf>

## **Appendix 2**

*John A. Cassara, Trade Transparency Unit Members: Statement to the Cullen  
Commission of Inquiry into Money Laundering in British Columbia, 2020*

## Appendix 2

### Trade Transparency Unit (TTU) Members<sup>i</sup>

<u>TTU Country</u>	<u>Year Formed</u>	<u>Data Sharing Frequency</u>
Colombia	2005	Monthly
Argentina	2006	Weekly
Brazil	2006	Monthly
Paraguay	2007	Monthly
Mexico	2008	Monthly
Panama	2010	Monthly
Ecuador	2011	Monthly
Guatemala	2012	Monthly
Australia	2012	Monthly
Philippines	2013	Under re-negotiation
Dominican Republic	2013	Monthly
Peru	2015	Monthly
France	2015	Biannually
Uruguay	2016	Quarterly
Chile	2016	Monthly
United Kingdom	2017	Annually
New Zealand	2019	Pending

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<sup>i</sup> "Trade-Based Money Laundering," United States Government Accountability Office (GAO), April, 2020, page 32; <https://www.gao.gov/assets/710/705679.pdf>

### **Appendix 3**

John A. Cassara, *Acronyms: Statement to the Cullen Commission of Inquiry into Money Laundering in British Columbia, 2020*

## Appendix 3 - Acronyms

AML/CFT	Anti-money laundering/Counter-terrorist finance
ARS	Alternative Remittance Systems
BMPE	Black Market Peso Exchange
CBP	Customs and Border Protection
CCP	Chinese Communist Party
CTRs	Currency Transaction Reports
DARTTS	Data Analysis and Research for Trade Transparency System
DHS	Department of Homeland Security
DLT	Distributed Ledger Technology
DOJ	Department of Justice
FATF	Financial Action Task Force
FinCEN	Financial Crimes Enforcement Network
FIU	Financial Intelligence Unit
FSRB	FATF-style Regional Body
GFI	Global Financial Integrity
HSI	Homeland Security Investigations
ICE	Immigration and Customs Enforcement
INCSR	International Narcotics Control Strategy Report
INL	Bureau of International and Law Enforcement Affairs
IRS	Internal Revenue Service
KYC	Know Your Customer
LEAs	Law Enforcement Agencies
MER	Mutual Evaluation Report
SBML	Service Based Money Laundering
SARs	Suspicious Activity Reports