TRADE BASED MONEY LAUNDERING (TBML)

IN CANADA AND BRITISH COLUMBIA

2015 – 2019

BY

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Introduction - Trade-Based Money Laundering

Money laundering can be defined, generally, as the process of concealing the existence, illegal source, or application of income derived from a criminal activity, and the subsequent disguising of the source of that income to make it appear legitimate. Deception is the heart of money laundering. The use of international trade to move money, undetected, from one country to another is one of the oldest techniques used to circumvent government scrutiny. International trade as a means of laundering money is also a technique generally ignored by most government law enforcement agencies.

This presentation details how false international trade invoicing is used to move money across borders, undetected. This presentation details how the statistical analysis of the U.S. trade data base and the Canadian trade data base can assist in detecting and measuring illegal money flows. It also details some statistical techniques that may be used to detect and monitor these abnormal transactions.

This presentation describes how new statistical profiling methodologies that evaluate transactions contained in a country's international trade data base can mitigate the risks associated with trade-based money laundering. This presentation discusses the application of four new trade-based money laundering profiling techniques which focus on country, customs district or Province, product, and transaction price risk characteristics.

Motivations for False Invoicing

Money may be moved out of a country to a foreign country by under-valuing exports or over-valuing imports. Money may be moved into a country from a foreign country by over-valuing exports or under-valuing imports.

The motivations and impact of trade price manipulation include:

Under-Invoiced Exports

- Money Laundering from Illegal Activities
- Terrorist Financing
- Income Tax Avoidance/Evasion
- Capital Flight
- Avoid Export Surcharges
- Conceal Illegal Commissions

Over-Invoiced Imports

- Money Laundering from Illegal Activities
- Terrorist Financing
- Income Tax Avoidance/Evasion
- Capital Flight
- Justify High Domestic Prices under Price Controls
- Conceal Illegal Commissions

Research Methodologies

During the past thirty years, various methodologies have been employed to analyze abnormal international trade pricing:

Country Average Price vs. World Average Price : In January 1992, *Money Laundering Alert* published the first article with results of an empirical analysis of trade-based money laundering. In that pioneering work, the average country price was compared to the average world price for every product. Abnormal international trade prices were determined based on this methodology. One of the criticisms of comparing country average prices with world average prices was that the analysis did not account for country/product heterogeneity. It was pointed out the imported dresses from Haiti were different from imported dresses from France. This led to modifying the data analysis methodology to take into account country/product differences.

Prices Fifty Percent Above or Below Average Country Price: The objective of this research methodology was to estimate the impact of over-invoiced imports and under-invoiced exports on the amount of money moved out of the United States during 1993. This methodology recognized that the characteristics of import and export transactions may vary among countries. Therefore, this methodology analyzed import and export transactions relative to historical U.S./Country trade. This analysis determined the total amount of money moved out of the United States in 1993 due to transactions at import prices greater than 50% of the average U.S./country commodity price and export prices less than 50% of the average U.S./country export commodity price. One of the main criticisms of the fifty percent deviation analysis was that the use of a fifty percent filter was arbitrary. This criticism was valid. In some cases the fifty percent filter may have been too low and in other cases it may have been too high.

Inter-Quartile Range Price Analysis:
In 1994, the United States Internal Revenue Service issued its 482 transfer pricing regulations and stipulated that the inter-quartile price range should be used to determine the validity of transfer prices in international trade. The IRS defines suspicious prices as those import prices that exceed the upper quartile import prices and those export prices that are less than the lower quartile export price. Based on the IRS defining the definition of arms-length pricing norms, the research methodology shifted to using the product/country inter-quartile price ranges as statistical filters.

APPLICATIONS OF INTER-QUARTILE RANGE STATISTICAL ANALYSIS

The 1994 Internal Revenue Service's specification that the inter-quartile price range is the relevant arms-length definition of normal pricing gave researchers a statistical benchmark for the analysis of international trade pricing. Thus, many additional international trade pricing studies were conducted based on the U.S. government's Merchandise Trade Data Base and the U.S. Government's definition of abnormal international trade pricing. The following are summaries of some of these studies:

Money Moved Out of and Into the United States and Canada: In addition to estimating the amount of money being moved out of the United States and Canada using the inter-quartile range analysis, the estimate of the amount of money moved into the United States and Canada was also determined. Money can be moved into the United States and Canada through over-valued exports and undervalued imports. The analysis also determined the illicit money flows by U.S. Customs Districts and Canadian Provinces.

Impact of New Banking Regulations on Money Moved Out of Switzerland: When central banking authorities enact legislation that only focuses on financial institutions, criminals and terrorists will find alternative techniques and channels to launder their money. The conclusion of a study based on the inter-quartile range analysis supports the argument that money launderers and terrorists will shift their money laundering activities to false invoicing in international trade.

Abnormal Weight: The terrorist attack of September 11, 2001 transformed the world's perspective on the terrorist movement. It was an event that changed the focus of all countries regarding the monitoring of their ports of entry in an attempt to protect themselves against the importation of weapons of mass destruction (WMD) and other contraband related to terrorist activities. In the United States, the enactment of the Patriots Act and the creation of the Department of Homeland Security were attempts to minimize terrorist related money laundering and smuggling.
Based on the inter-quartile analysis of the weight characteristics of U.S. import data thousands of import transactions with abnormal weights were observed. The implications regarding port security are crucial for the development of the policies necessary to protect the citizenry from international terrorism.

Investigating Abnormal International Trade Pricing: The interquartile range pricing analysis has been used in the investigation and prosecution of individuals engaged in abnormal international trade pricing.

Detecting Abnormal International Trade Pricing: Methodologies have been developed to assist law enforcement agencies and financial institutions to detect possible trade price manipulations. The analysis resulted in the development of the Country Risk Index. Customs District or Province Risk Index, and the Product Risk Index. An analytical program has been developed to determine possible abnormal pricing in real time. All that is needed to implement the system is a connection to the internet. The Transfer Price Profiling System (TPPS) is based on the interquartile range analysis. The International Price Profiling System (IPPS) is a more stringent analysis to be used by financial institutions analysis of trade financing decisions.

CANADA AND BRITISH COLUMBIA ANALYSIS:

2004 Presentation – Ottawa Canada: I was invited to present my research to various Canadian government agencies. My presentation was based on the analysis of the U.S. trade data base.

2015 – 2019 Canada and British Columbia Analysis – I was given access to the Canada merchandise trade data base for the years 2015 through 2019. The following reports were produced. I will detail the 2019 reports today.

Macro Reports - Annual Canada International Trade Pricing Analysis Reports
2015, 2016, 2017, 2018, and 2019.

These reports contain the following information:
TOTAL MONEY MOVED OUT OF CANADA BY COUNTRY: RANKED BY DOLLAR VALUE
TOTAL MONEY MOVED OUT OF CANADA BY COUNTRY: RANKED BY PERCENT OF TRADE
TOTAL MONEY MOVED OUT OF CANADA BY PROVINCE: RANKED BY DOLLAR VALUE
TOTAL MONEY MOVED OUT OF CANADA BY PROVINCE: RANKED BY PERCENT OF TRADE
TOTAL MONEY MOVED INTO CANADA BY COUNTRY: RANKED BY DOLLAR
TOTAL MONEY MOVED INTO CANADA BY COUNTRY: RANKED BY PERCENT OF TRADE
TOTAL MONEY MOVED INTO CANADA BY PROVINCE: RANKED BY DOLLAR VALUE
TOTAL MONEY MOVED INTO CANADA BY- PROVINCE: RANKED BY PERCENT OF TRADE
TOTAL TRADE BY COUNTRY - CANADA EXPORTS AND IMPORTS
TOTAL TRADE BY PROVINCE - CANADA EXPORTS AND IMPORTS

Micro Reports – Money Moved Out and Into British Columbia: Detailed Transactions
2019

Examples of 2019 transactions that may be at suspicious international trade prices.

CONCLUSION

MITIGATING TRADE BASED MONEY LAUNDERING

STATISTICAL ANALYSIS OF CANADA TRADE DATA BASE

ANALYZE HISTORICAL TRADE TRANSACTIONS

ANALYZE REAL TIME TRADE TRANSACTIONS

FOLLOW THE DATA