

EAГ ♦ EAG

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EURASIAN GROUP

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Transactions

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Introduction

The study Risks of Money Laundering in a Foreign Economic Activity was made by the decision of the Eleventh Plenary Session of the Eurasian Group on Combating Money Laundering and Financing of Terrorist Activities (hereinafter EAG).

This study was based on the results of the typologic study Application of Foreign Trade Transactions for Money Laundering carried out in 2009 by the Finance Intelligence Unit of the Republic of Belarus in the framework of EAG.

Given the data on identified methods, schemes, instruments used for money laundering in foreign trade transactions¹, given the analysis of identified “suspicion indicators”, it is suggested to develop the Assessment Tool for Foreign Trade Risks and Exposure (hereinafter the Risk Assessment Tool) based on the Bayesian theorem.

In addition, the model was designed using the modules of the National Risk and Exposure Assessment Tool worked out by the World Bank experts, as well as information provided by finance intelligence units from Armenia, Tajikistan, Uzbekistan, Kyrgyzstan and the Ukraine.

Objective of the study is development of the risk assessment methodology and practical nationwide implementation of the Risk Assessment Tool by respondents to prevent and combat use of foreign trade transactions in money laundering schemes.

Central aspects of this study included identification of legal aspects in foreign trade regulation, efficiency assessment of the national systems for prevention of money laundering/financing of terrorist activities as part of the risk assessment, analysis of foreign trade monitoring by financial institutions and special authorized agencies.

¹ A foreign trade transaction is a complex of activities undertaken by parties from different countries, aimed at trade exchange and providing for such trade exchange.

The subject of a foreign trade transaction may include goods, works, services, information, results of intellectual activity.

Summarized results of the previous typologic study and indicators of suspicious financial transactions became the basis for development of criteria for money laundering risks in foreign trade transactions.

Money laundering in a foreign trade activity is a great hazard for the international economy, say nothing of backlashes on the national economy, development and integrity of financial systems, inflow of foreign investments and private sector development. It is essential that countries accurately determine financial transactions with a high risk of use and greater exposure to money laundering and financing of terrorist activities.

Assessment of risks and exposure will be beneficial in ordering of priorities and reform programs in jurisdictions.

Better understanding of risks and exposure contributes to the ultimate goal of governmental authorities, i.e. efficient regime for combating of money laundering and financing of terrorist activities.

We voice a hope that this study will allow develop a methodology for identification of suspicious financial transactions associated with a foreign trade activity and will become the framework for realization of this tool in the relevant software engineering.

Evidently, every country and its national authorities shall identify the most feasible regime adjusted to risks of this particular country.

Thus, we try to ensure not a unified approach based on risk assessment but rather to work out broader guidelines based on principles and procedures that may be considered by countries when applying the Risk Assessment Tool.

Chapter 1. Status of a Money Laundering Issue in Foreign Economic Transactions

1.1. Regulation of a Foreign Trade Activity.

Today international trade plays a key role in economic advancement of countries, regions and world community at large: foreign trade has become a powerful growth factor, the countries' dependence on international exchanges has seen a drastic increase.¹ Advancement of trade among countries is not all about positive trends. This sector remains attractive for crimes associated with money laundering. The relevance of this study is based on a great social danger and threats aligned with repatriation of cash assets.

International trade is inherently vulnerable and exposed to risks that enable criminals to launder money with a rather low probability of detection.

Such risks constitute a lion's share in the overall foreign trade volume owing to the lack of the customs data sharing among the countries; difficulties in exchange of foreign currency for international trade, as well as owing to the fact that customs authorities have scarce resources for disclosure of illegal trading transactions.²

The principal condition in prevention of corrupt practices associated with trade-based money laundering is the legal framework that regulates foreign trade on the national level.

Integrity of this framework and its compliance with international standards and guidelines reduces probability of foreign trade use for money laundering by business entities.

As described in the previous study conducted by colleagues from the Belarusian Finance Intelligence Unit, state regulation of a foreign trade activity, currency regulation and exchange control aim, in the first line, at stability of the national money being a prerequisite for successful performance of contemporary economy.

Exchange control of a foreign trade activity includes:

- State and other institutes, agencies, people involved in exchange control;
- Complex of control forms and methods.³

According to Art.9 Law of the Ukraine on Foreign Trade Activity, the Ukrainian Ministry of Economy (hereinafter the Ministry of Economy) is charged with control of a foreign trade activity of the Ukrainian and foreign economic entities that breach the current Ukrainian legislation on prevention of illegal loss of currency and material valuables.

¹ Wikipedia -<http://ru.wikipedia.org>

² <http://www.lawyersweekly.ca> – “Trade- based money laundering” by Christine Mingie dated 17, July, 2009.

³ Typological study “Application of Foreign Trade Transactions for Money Laundering”, FIU of Belarus, Guilin, December 2009.

The Ministry of Economy may impose special sanctions on entities engaged in foreign trade activities and is charged with cooperation with other executive authorities involved in control of this area.

Foreign economic transactions have a potential for sham transactions aimed at illegal VAT offset and underdeclaration of imported goods to evade taxation etc.

State tax services of the Ukraine have been partly charged with enforcement of tax and currency laws on economic entities, proposal of legislative development in accordance with the applicable procedure, prevention of crime and other offences in the competence of the tax police etc.

Exchange regulation of a foreign trade activity in the Ukraine is exercised by the National Bank by means of a foreign exchange policy, issuance of licenses for exchange activities and revocation thereof; establishment of foreign exchange rates.

Moreover, the Ukraine specifies obligations of government agencies and banking system in exchange control, according to which the National Bank is the central exchange control agency that monitors adherence to the exchange activities regulations in the Ukraine, provides for performance of exchange control duties by authorized banks in accordance with the Ukrainian currency legislation.

Authorized banks, financial institutions and the mail service operator, that were issued block licenses for exchange activities by the National Bank of the Ukraine, control exchange activities of both residents and nonresidents carried out in these institutions.

The Ministry of Communications of the Ukraine controls adherence to the regulations on postal money orders and remittance of currency valuables across the Ukrainian border.

To ensure compliance with the national legislation, including customs laws, and international treaties, the enforcement of which lies on customs authorities, the states establish customs control as a complex of activities exercised by customs authorities.

Customs clearing is a complex of customs procedures that implies customs activities in respect of commodities and vehicles carried across the customs border.

The State Customs Service of the Ukraine exercises customs control in accordance with the effective laws of the Ukraine.

In the Republic of Armenia regulation of a foreign economic activity lay on the Ministry of Economy of the Republic of Armenia. Control of this sphere is, to a large extent, realized by the Internal Revenue Committee under the Government of the Republic of Armenia which includes a customs authority for import and export of goods and a revenue service for management and supervision of tax liabilities.

Regulation of foreign economic and foreign trade activities in the Republic of Tajikistan depends on the form of state control and, according to Art.6 Law of

Tajikistan on Government Regulation of a Foreign Trade Activity, is charged with various state agencies. Majilisi Oly of the Republic of Tajikistan authorizes issuance and raising of public credits, as well as economic aid to other states, their legal entities and international organizations. The Government of the Republic of Tajikistan, the Ministry of Economic Development and Trade of the Republic of Tajikistan, the Customs Service under the Government Republic of Tajikistan and the National Bank of Tajikistan within their powers exercise government regulation of a foreign economic activity.

According to the Law of the Republic of Uzbekistan on a Foreign Trade Activity, the authorized governmental body for regulation of foreign trade activities is the Ministry for Foreign Economic Relations, Investments and Trade of the Republic of Uzbekistan.

The Central Bank, the Ministry of Finances, the State Tax Committee and the State Customs of the Republic of Uzbekistan are the exchange control agencies according to the Law of the Republic of Uzbekistan on Exchange Regulation.

Within their powers and in accordance with the applicable procedure the exchange control agencies monitor legal compliance of exchange activities undertaken by both residents and nonresidents in the Republic of Uzbekistan.

In the Republic of Kyrgyzstan a foreign economic activity is controlled by the Ministry for Economic Regulation.

In all participant countries of the study carried out by the Belarusian Finance Intelligence Unit there are specific agencies authorized for control of foreign trade transactions and exchange control agencies.

Besides, in some countries foreign trade organizations are obliged to report details of foreign trade transactions violating the legislation to the authorized governmental bodies.

1.2. Restrictions of a Foreign Trade Activity.

As determined in the previous study, jurisdictions stipulate special procedures to enforce currency laws, control capital exports and accuracy of transactions (lack of sham signs), control export without charging or at underestimated prices etc.

Control of foreign trade transactions includes some other measures as well, for example, quota arrangement, licensing, certification of goods, works and services, execution of certificates of origin.

Due to the membership of the Republic of Armenia in WTO there are no restrictions to a foreign trade activity in Armenia.

According to the legislation of the Republic of Tajikistan and recognized international treaties with other republics, Tajikistan may prohibit or restrict export and import of goods (works, services), intellectual property, on account of national interests with a view to maintain public morality and law order; protect life and health of people, protect fauna and flora and the environment at large; preserve cultural heritage of the Republic of Tajikistan, secure cultural values from smuggling and illicit transfer of title thereto; prevent depletion of irreplaceable natural resources; ensure national security of the Republic of Tajikistan; secure external and internal credit standing and maintain the foreign balance of the Republic of Tajikistan; perform international obligations of the Republic of Tajikistan.

All countries stipulate administrative responsibility for violation of foreign trade restrictions, including amercement and cancellation of licensing documentation.

In the Ukraine illegal buying-up, sale, exchange or use of currency valuables as an instrument of payment or pledge, i.e. performance of these activities without relevant permits (licenses) where such permits (licenses) are mandatory in accordance with the currency laws, entail administrative or criminal liability according to the effective Ukrainian legislation.

The following punitive measures (pecuniary sanctions) apply to the violators of the exchange control and exchange regulations:

- For currency valuables transactions without a blanket license of the National Bank – a fine equal to the sum (cost) of such currency valuables converted in the Ukrainian currency at the exchange rate of the National Bank as of the day of transactions;

- For currency valuables transactions subject to licensing by the National Bank without an individual license of the National Bank - a fine equal to the sum of such currency valuables converted in the Ukrainian currency at the exchange rate of the National Bank as of the day of transactions;

- For foreign exchange trading by banks and other financial institutions, or the national mail service operator without a license of the National Bank of the Ukraine and/or in violation of procedures and terms of currency valuables trade at the Ukrainian interbank foreign exchange market set forth by the National Bank - a fine equal to the sum (cost) of such currency valuables converted in the Ukrainian currency at the exchange rate of the National Bank as of the day of transactions;

- For failure of authorized banks to perform duties, for failure of authorized banks, financial institutions or the national mail service operator to perform obligations – cancellation of the blank license for exchange activities issued by the National Bank or a fine in the amount set forth by the National Bank;

- For residents' breach of a settlement procedure - a fine equal to the sum of currency valuables used for settlements, converted in the Ukrainian currency at the exchange rate of the National Bank as of the day of transactions;

- For late, covered-up or falsified exchange transactions accounting - a fine in the amount set forth by the National Bank;

- For residents' failure to comply with requirements to declaring currency valuable and other property - a fine in the amount set forth by the National Bank. Penalties stipulated by this clause shall be imposed by the National Bank and based on its decision – by subordinate agencies. Punishment administration may be appealed against juridically.

Collected fines go to the national budget of the Ukraine.

To prevent illegal outflow of currency valuables outside the Ukraine and to encourage entities engaged in foreign economic activities to bring their activities in line with the effective Ukrainian legislation, since the beginning of 2009 the Ministry of Economy of the Ukraine, by virtue of the Ukrainian Law on Foreign Economic Activity, imposed special sanctions on 664 entities engaged in foreign economic activities (of which non-residents - 329) for violation of the effective foreign economic legislation, including for arrears in foreign economic operations totaling US\$51.5 mln.

The above special sanctions were imposed by the Ministry of Economy as advised by the agencies of:

State Tax Service - 476,
Security Service - 176,
State Customs Service - 10,
Judiciary - 2.

Those measures contributed to return of currency and material valuables totaling US\$20.6 mln into the Ukraine.

If the customs declaration regulations are breached in the course of foreign trade transactions in Armenia, fines are imposed on violators (according to Chapter 37 Customs Offence and Sanctions of the RA Customs Code).

Effective legislation of the Republic of Tajikistan stipulates administrative and criminal liability for breach of the foreign economic and foreign trade legislation.

Legislative acts of the Republic of Uzbekistan may set export/import bans and restrictions for goods (works, services). In particular, the Decree of the President of the Republic of Uzbekistan On Additional Incentives for Export of Goods (Works, Services) stipulates additional conditions for export and import of specific goods, the list of goods banned for export/import.

Resolutions of the Cabinet of Ministers of the Republic of Uzbekistan On Enhancement of Control in Use of Foreign Currency Facilities in Foreign Trade Transactions and

On Further Advancement and Strengthening of the OTC Money Market set forth restrictions to the dates of delivery, payments and receipt of currency earnings.

Accordingly, resident legal entities with delay in receipt of currency earnings from abroad for more than 30 banking days (in 2009 - 60 banking days) after termination of the stipulated deadlines shall pay a fine to the republican budget equal to 100 percent of the non-received currency assets.

The Administrative Code of the Republic of Uzbekistan stipulates the following administrative liabilities for breach of the foreign economic legislation:

- Late or short transfer of foreign currency by employees of enterprises, institutions, organizations and banks engaged in exchange activities to foreign currency accounts in the authorized banks of the Republic of Uzbekistan; avoidance of mandatory sale of a part of currency earnings in accordance to the procedure and sizes established by the law; violation of the established export/import procedure – imposes a fine on officials.

The Criminal Code of the Republic of Uzbekistan stipulates criminal liability for violation of the foreign economic legislation:

- Conclusion of a scienter bad deal by an official of a state agency, enterprise, institution, organization, notwithstanding the form of ownership, public association, that has inflicted a large-scale damage to the republican interests - a fine or divestiture of a particular right for up to five years, or correctional labor for up to three years or arrest for up to six months;

- The same, committed repeatedly by a group of persons by previous concert with infliction of a particularly large-scale damage - a fine of fifty to a hundred minimum earnings or custodial restraint for up to five years with divestiture of a particular right;

- If the inflicted material damage is compensated in a threefold amount, no arrest or custodial restraint shall be imposed;

- Deliberate concealment of foreign currency, subject to crediting to the authorized banks of the Republic of Uzbekistan, by persons engaged in exchange activities at enterprises, in institutions or organizations – a fine of seventy-five to a hundred minimum earnings or divestiture of a particular right for the period up to three to five years or custodial restraint for up to five years;

- The same, committed for mercenary motives, repeatedly, by a group of persons by previous concert - custodial restraint for up to five to eight years;

- The same, committed by the organized group or in interests thereof - custodial restraint for up to eight to twelve years.

- Conveyance of goods or other valuables across the customs border of the Republic of Uzbekistan in avoidance of or with concealment from customs inspection or with fraudulent documents or customs identification facilities, or related to non-declaration or declaration under the wrong name, committed in a

large amount, after imposition of the administrative sanction for the same activity – a fine or correctional labor for the period up to two years or custodial restraint for up to five years.

- Breach of the customs legislation, committed on an especially large scale, by break-through, i.e. open, unauthorized conveyance of goods or other valuables across the customs border of the Republic of Uzbekistan; by the organized group or in interests thereof; in connection with using the duties of offices – a fine of three hundred to six hundred minimum earnings or correctional labor for the period up to three years or custodial restraint for the period of five to eight years.

1.3. Positive Nationwide Measures Undertaken by Jurisdictions to Combat Money Laundering and Financing of Terrorism.

It shall be noted that in 2009 the National Bank of the Ukraine consolidated and analyzed the results of bank checks concerning realization of money laundering schemes by bank clients. Based on that there have been worked out the Typical Financial Schemes Used for Capital Outflow Outside the Ukraine or Associated with Money Laundering that were delivered to the area offices of the National Bank with view of further use for revelation of financial transactions and termination thereof by appropriate retaliation.

1.4. Conclusions by Chapter 1.

Given the analysis of the above information it may be concluded that restrictions of an external economic activity and sanctions imposed on violators of the national foreign economic legislation are generally similar in the countries of this study.

Moreover, the influence area of state agencies that regulate this activity is practically the same. This means that in order to apply the Risk Assessment Tool in the jurisdictions of future studies, it would be feasible that the participants were state agencies (in accordance with the national system), including:

- Ministry of Economy,
- Ministry of Finance;
- Customs Service;
- Tax Service;
- National Bank,

and that consolidation and additional analysis were carried out by a designated authority for financial monitoring with view coordinate activities and initiate amendments to the national legislation.

In our view, poor management of risks inherent to foreign trade transactions may result in:

- Increase of the shadow economy sector;
- Increased exposure of the national currency due to growth of exchange rates;
- Disequilibrium of the country's economic system;
- Decreased economic security of the state;
- Deteriorated competitive power of home producers;
- Formation of the negative image of the country at the international level etc.;

Management of risks of money laundering and terrorist financing inherent to foreign trade transactions in terms of general economic risk management is a determinant of persistent dynamics and socio-economic development of states. These risks are closely related to the risks of capital repatriation, reduced tax liabilities of entrepreneurs and other law violations in the field of foreign economic activity.

Chapter 2. National Frameworks for Assessment of Money Laundering Risks.

2.1. National Risk (Factor) Assessment that May Influence the Risk Level of Money Laundering and Financing of Terrorism (ML/FT).

The national risk assessment of money laundering/financing of terrorist activities is an organized and systematic program of works to reveal and assess sources and methods of money laundering and financing of terrorist activities, and also to detect faults in the system combating money laundering and financing of terrorist activities as well as other exposures with a direct or indirect effect in the country of the assessment.

In general, the national risk assessment of money laundering/financing of terrorist activities is a process that usually provides information on the following:

- Nature and scale of money laundering/financing of terrorist activities and related predicate crimes (for example, threats);
- Faults of the anti-money laundering system, the surveillance system as well as other particular qualities of the jurisdiction that make it attractive for money laundering (for example, exposure).

Some risk assessment measures have already been taken in certain jurisdictions of this study.

Thus, with view to assess the risk in the sphere of money laundering/financing of terrorist activities, the Financial Monitoring Center of the Central Bank of the Republic of Armenia (FMC) has worked out the Guidelines on Strategic Analysis of Risks of Money Laundering/Financing of Terrorist Activities in the Republic of Armenia. The Guidelines were approved by the Interagency Committee for Falsification and Fraud of Plastic Cards and Other Payment Instruments, for Combating of Money Laundering and Financing of Terrorist Activities (Interagency Committee). According to these Guidelines, the national risk (factors) assessment of money laundering/financing of terrorist activities is in the final analysis stage.

According to the Guidelines on Strategic Analysis of Risks of Money Laundering/Financing of Terrorist Activities in the Republic of Armenia, these risks are considered in seven sectors/industries:

- Risks associated with the growth of predicate crime rates,
- Risks associated with gaps and discrepancies in the legal framework,
- Risks associated with faults of the institutional system,
- Financial sector risks,
- Risks in non-financial industries,
- Risks in the nonprofit sector,

– Risks associated with the economic assets, geography and ethnography of the country.

In addition, risk assessment in the Republic of Armenia involves the following agencies and departments:

- FMC (also a coordination function),
- Public Prosecution of the Republic of Armenia,
- National Security Service of the Republic of Armenia,
- Police of the Republic of Armenia,
- Internal Revenue Committee of the Republic of Armenia,
- Judicial Administration of the Republic of Armenia,
- Financial Monitoring Directorate of the Central Bank of the Republic of Armenia,
- Statistics Administration of the Central Bank of the Republic of Armenia,
- Ministry of Finance of the Republic of Armenia,
- Ministry of Justice of the Republic of Armenia,
- State Immovable Property Cadastre Committee of the Republic of Armenia,
- National Statistics Service of the Republic of Armenia.

Analysis of strategic ML/FT risks assessment in the Republic of Armenia is recurrent and shall be carried out subject to the dates stipulated by the Interagency Committee with regularity of every 1-2 years.

Routine analysis of strategic ML/FT risks stipulates a statement on the operating performance ratio of the national AML/FT system. This analysis is also a part of separate stages of the Armenian AML/FT system assessment carried out by the MONEYVAL Committee under the Council of Europe.

With view to strategic ML/FT risk analysis there have been worked out individual questionnaire forms subject to completion by every authorized agency/ organization. Consolidation and further analysis of completed questionnaires is made by the Financial Monitoring Center of the Central Bank of the Republic of Armenia. Criteria used in risk assessment were developed based on the FATF document “ML/FT Risk Assessment Strategies” of June 18, 2008.

As part of the risk assessment program neither the national assessment of risks (factors) that may affect the ML/FT risk level in the country nor the performance evaluation of the national system for combating money laundering/financing of terrorist activities has been carried out in the Republic of Uzbekistan or the Republic of Tajikistan.

However, algorithms for assessment and identification of transactions associated with foreign economic activity are set forth in the Order of the State

Customs Committee of the Republic of Uzbekistan which has been based on the Law of the Republic of Uzbekistan on Foreign Economic Activity. Alongside, data acquisition via the customs risk management software in the Electronic Data Processing System EDPS designed for the customs authorities of the Republic of Uzbekistan is practiced on a wide scale.

Besides, in Tajikistan the risk will be assessed under the direction of the Financial Monitoring Directorate of the National Bank in partnership with all ministries and departments, fiscal and customs authorities, economic entities, law enforcement authorities using all available data (statistics, applicable legislative acts), including information received from participants of foreign economic activity.

The Republic of Kyrgyzstan implements numerical risk assessment models, mainly the binary number approach which is widely used in combinatorial analysis, and the Bayesian modeling.

In the Ukraine, the National Bank has done the study “Modeling of Risks of Banks Use for Money Laundering or Financing of Terrorist Activities” which was also based on the combinatorial theory and the Bayesian model.

In the State Customs Service of the Ukraine there has been set up the Department for Analysis, Risk Management and Audit, approved by the Order of the State Customs Service of the Ukraine in accordance to which this structural unit shall:

- Along with other structural units of the State Customs Service of the Ukraine provide for and implement in the customs authorities the risk analysis and management system used during customs control of goods movement across the customs border of the Ukraine and clearance of such goods;

- Analyze the risk causes and conditions;

- Monitor registration of risk profiles with the computer-based risk analysis and management system in the Unified Computer-Based Data System of the Customs Service;

- Gather, classify and analyze the results of risk profile application by the customs authorities, evaluate efficiency of risk profiles, work out amendments to risk profiles;

- Organize, implement and maintain the system for analysis and management of risks in official activities of the customs officers.

Besides, it is noteworthy that the *principal features and criteria* of money laundering in foreign trade include:

- Prepayment under foreign trade agreement with further cancellation of such agreements and refund of such prepayment;

- Purchase and sale of “technical” shares, other counterfeited non-state securities where one of the parties is a non-resident company;

- Provision of documents to the customs authorities containing knowingly false facts on the goods imported into (exported from) the customs area;
- Long-term financial aid agreements between a resident and a non-resident;
- A long-term interest-free foreign currency loan granted by a non-resident;
- Purchase with further repatriation of large amounts of currency assets by a resident along with submission of accounting on minor financial results of the activity.

Often “foreign economic schemes” of money laundering are cyclic (occur over and over) and are supervised by embezzlement of state funds, i.e. illegal VAT refund from the budget (the so-called “carousel fraud”)⁵.

A typical scheme involving “pseudo-export” transactions is as follows (Fig.1).

A business entity actually conducts business, formalizes receipt of goods and other valuables (including unfit for use) from the so-called “transit” or sham businesses. Then the allegedly received goods, i.e. without practical realization of the export transaction, are exported to a fictitious or deliberately set-up non-resident company. Documents supporting realization of the export transaction are forged. Besides, subsequent to such transaction the export company may get unwarranted VAT refund from the budget.

⁵ Over the recent decade the “carousel” fraud with illegal refund of export VAT has become a threat for the European Union countries as well. Approximate estimates of the European Commission reveal that annual amount of illegal VAT refund in the European Union countries may be 60-100 billion euro, which, in view of a huge sum, is a threat for the economic cohesion and safety of such countries.

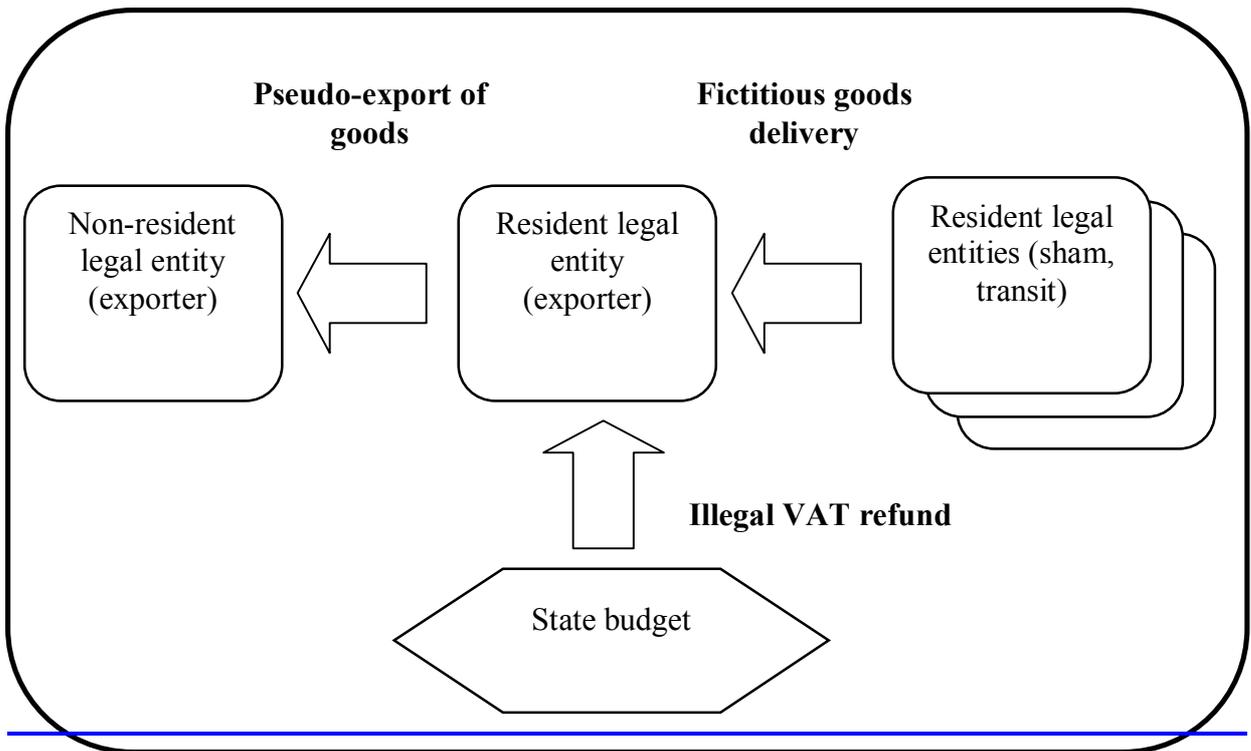


Fig. 1 Typical scheme involving pseudo-export transactions

Accordingly, the results of the inappropriate management of risks inherent to foreign trade include:

- In case of import – state damage in terms of non-payment of taxes, customs charges etc., legalization of facilities (goods) obtained by illegal means outside the Ukraine;

- Repatriation of currency assets using “technical” securities, forged documents (contracts, statements of release and acceptance etc.) implies repatriation of illegal monetary assets and outflow of assets of the operating enterprises outside the country;

- Illegal export transactions pose a risk of:

- Non-return of export currency earnings;

- Undercharge / overpricing of exports;

- Disagreements in the exported goods stock-list;

- Export under forged/lost documents;

The usual consequence of such transactions is the state damage in terms of understatement of taxes and customs charges, inflow of assets into the jurisdiction obtained by illegal means abroad.

With view to enhance efficiency of the risk assessment, to minimize the risks and to prevent use of foreign trade transactions for money laundering, it is

reasonable to conduct routine information sharing between executive and law enforcement authorities concerning non-resident companies recognized as illegitimate and legitimate companies involved in money laundering schemes.

Given this, it would be feasible to charge the functions of foreign trade risks assessment with each executive authority and law enforcement authorities.

Therefore, with view to assess the risks of each jurisdiction and identify exposures of the national AML/FT system at large and foreign trade in particular, we suggest to apply in this study the national risk assessment model Risk Assessment Tool composed of two modules:

- Country's attractiveness in terms of money laundering;
- Exposure of the foreign economic sector on a domestic level.

2.2. Outline of the Risk Assessment Tool.

The objective of the Risk Assessment Tool is to determine the level of risks on the national level and in the relevant sectors, in this particular case – in the foreign economic sector.

The Tool analyzes the risk profile in order to identify the elements and principal sources of the risk, evaluates temporary risk changes and delivers information on prioritization and ranking of limited resources for arrangement and minimization of the identified risks.

It also helps the officials assess the impact of unadopted measures or alternatives. This Tool may be used for measurements, diagnostics and decision-making.

The national risk assessment makes allowance for various channels of information to be used in the risk assessment and containing internal irretrievable inaccuracies, there shall be also used the Bayesian network model for representation of an integrated risk factor network.

The Bayesian model allows consolidation of inconsistent datatypes into a clear analytical and logically bracketed model. It also reveals the correlation between numerous factors of the causality-based risk⁶.

Assessment of money laundering risks involving foreign trade transactions may be treated in a number of aspects, including:

- In respect of compliance with the customs legislation (risk management in customs procedures);
- In respect of compliance with the currency control legislation etc.

Likely consequences of poor customs risk management for the state may be conventionally classified into two main groups:

⁶ Ref. Appendix 1.

- Threat to the state fiscal policy (tax payments deficiency, tax evasion, and also probable damage to the national manufacturers);

- Threat to the population safety (illegal traffic of drugs, psychotropic substances and precursors, weapon, toxic agents and dangerous refuse etc. across the Ukrainian customs border).

The national risk assessment model includes three modules:

- Illegal proceeds (received domestically or abroad);

- Country's attractiveness for money laundering (economy, financial market, geographical setting, institutional power, general anti-money laundering regime etc.);

- Exposure of the foreign economic sector on a domestic level.

Weak points of the foreign trade sector shall be assessed based on a number of factors that influence the risk level of goods and services in the sector.

2.3. Risk Assessment Criteria through the National Risk Assessment Model.

Individual perception of risks may vary among the regulators and subjects of the initial financial monitoring. What some may treat as a high risk, may be classified as an average risk by others.

The goal of the Risk Assessment Tool is not to identify the money laundering risk based on one criterion but to coordinate the respondents to assess risk by regular realization of the procedure, to determine the risk criteria and to create an efficient anti-money laundering method based on such criteria.

Lots of factors can make the country vulnerable for money laundering through foreign trade transactions. Some factors exercise a direct impact, others have a more mediated effect.

The role and influence of a particular factor is often based on availability or lack of others.

To assess the country's exposure there has been worked out a risk assessment model aimed at identification of key variables and other interrelations.

In this Risk Assessment Tool these factors are given as variables. Each variable stands for a certain thing in the bulk of financial transactions associated with foreign trade. For example, a variable "Money Laundering Laws and Regulatory Acts" reveals the degree of compliance of the jurisdiction laws and regulatory acts with the international standards.

The model includes two types of variables: intervening variables and input variables.

Intervening variables are variables with a broader and a higher-level concept. In other words, this allows easier disaggregation of the concept or review of the influences to assess variables of a more exact level.

Accordingly, there is no assessment at the level of intervening variables. Assessment may be carried out at the level of input variables. Input variables are variables that are assessed easier and more precisely compared to intervening variables or they allow easier decision-making.

Intervening variables are determined automatically using the model subject to the values entered into the input variables.

This study outlines each variable and criteria that shall be accounted for by the respondents giving a probable assessment for each variable.

For example, assessing the criterion for the variable “Money Laundering Laws and Regulatory Acts”, the respondent will assess the degree of compliance of the jurisdiction laws and regulatory acts with the international standards.

The criterion for the quality compliance of the money laundering laws and regulatory acts with the standards will be assessed as: High, High/Average, Average, Low/Average, or Low.

As a rule, the assessment criterion specifies when the degree or probability shall be classified as High. Still, it doesn't specify that the probability exponent is Average or Low when one or several criteria are lacking.

Registration of rating grounds plays a key role in a repeated assessment. Variant results may indicate changes in the exposure conditions if ratings are based on the same grounds.

To realize the first module of the Risk Assessment Tool one shall refer to Appendix 2 and analyze suggested directions (prepared based on the World Bank material techniques).

The national risk assessment model of the World Bank shall be a methodical basis for flexibility implementation stipulated by the FATF Recommendations on the risk-based approach. Although compliance with the FATF Recommendations is the respondents' target, this shall not be the ultimate goal as such. Most likely, the ultimate goal shall be the efficient regime concerning money laundering/financing of terrorist activities that would complicate money laundering and financing of terrorist activities.

Risk assessment goals include:

- Understanding of money laundering resources and methods in the country;
- Understanding of system drawbacks and factors attractive for money laundering;
- Understanding of the foreign trade exposure;
- Understanding of the general risk level of money laundering in the country;
- Analysis of the risk profile to understand its components and key sources;

- The ultimate goal of the risk assessment is the enhanced national regime in terms of money laundering/financing of terrorist activities at large and foreign trade activity in particular.

In this typologic study (questionnaire form) we suggested outlining a methodology for risk assessment in each country and specifying, among others, availability of the below criteria in the methodology:

- Political situation;
- Legal situation;
- Economic setup of the country;
- Culture factors and type of the civil society;
- Sources and concentration of criminal activity;
- Volume of the financial services market;
- Property structure of enterprises rendering monetary services;
- Volume and types of activities undertaken by unregistered or non-licensed institutions that render monetary services;
- Corporate administrative measures at the enterprises rendering monetary services;
- Peculiar features of payment systems and prevalence of cash transactions;
- Geographical range of transactions and clients of the financial services sphere;
- Types of goods and services offered at the financial market;
- Types of customers to which monetary services are rendered;
- Types of predicate crimes;
- Amount of illegal assets received within the country;
- Amount of illegal assets received abroad and laundered in the homeland;
- Basic channels and methods used for money laundering and financing of terrorist activities;
- Affected sectors of the legal economy;
- Shady/ nonofficial economy sectors.

These parameters have become a basis for determination of risk assessment criteria in terms of the Risk Assessment Tool, both on the national level, and in the foreign economic sector.

2.4. Risk Assessment Criteria through the Risk Assessment Model in a Foreign Economic Activity Sector.

Given the information provided by the countries participating in the previous typological study, FIU of Belarus pointed out three suspiciousness indicator groups, on the basis of which reasonable decisions on the use of foreign trade transactions for the purposes of money laundering can be taken.

These indicators can be determined with regard to organization and founder's and registration data (group 1); financial transaction format and financial profile of accounts (group 2); foreign trade transaction documentation (group 3).

Suspiciousness indicator group 1 (with regard to registration data):

- Financial transaction participant – the resident is registered in one region, and the account is opened in another region of the country;
- It is impossible to determine a physical location of a client company;
- The functions of the founder, director and chief accountant are exercised by one person;
- Transactions are carried out with a lost or forged passport;
- Offshore companies and offshore jurisdictions are used in settlement procedures

Suspiciousness indicator group 2 (with regard to financial transactions and their nature):

- The amount and value of commodities do not comply with the actual value, customary business practice and client's capabilities;
- Cyclicity of one-type transactions between the participants of the scheme;
- Handling accounts in the shortest possible time (often within one day);
- Apparent non-compliance of turnovers as per a company's accounts with the amounts of additional payments (taxes, pension fund payments, customs payments, etc., for example, significant discrepancy between the amount of the paid goods delivery tax and information in the invoice);
- Payment for commodities without their importation to the territory of the country;
- Prepayments (including customs payments and payments to offshore companies) by the dummy-featured businesses, especially by start-up companies;
- Settlements are carried out for goods, works, services which do not correspond to the type of the business entity's activity (for example, settlements for food products in the event that receiving transactions are mainly associated with settlements for non-food products);

- The type of transactions gives evidence that such transactions are directed towards evasion of mandatory control procedures or attachment (blocking) on the part of financial intelligence units and other authorized bodies;
 - Supplier and purchaser's settlement accounts are in one and the same bank;
 - Accounts are opened against lost documents;
 - Non-resident purchaser's settlements for exported goods are carried out from the account in the resident bank;
 - Lack of economic benefits under transactions with bills of exchange, securities for the bearer, which are included in the scheme;
 - Transactions with "technical" shares, sale and purchase of other forged non-state securities when one of the parties to the agreement is a non-resident (legal entity or physical person);
 - Long-term financial aid agreements between a resident and a non-resident;-
 - Execution of payments by third parties or for the benefit of third parties that lack an explicit relation to the transaction;
 - Settlements with a non-resident is registered in the country different from the servicing bank country (in particular – associated with the companies registered in the offshore zones but having accounts in the Baltic countries, for example), especially in cases of remittance to third persons which are not transaction parties under loan agreements;
 - A long-term inters-free foreign currency loan extended to a non-resident by a resident;
 - Export under commission agreements through the contract holder to an offshore company's address;
 - Bank loan or credit receipt from a legal person to the amount of VAT offset (primary framework financing);
 - Evident incompliance of incoming / initial payment reasons imitated by the integrated production cycle;
 - Transit of the same amount through accounts of a great number of scheme participants during the banking day;
 - Export and import operations by non-core companies for a specific product type (metal-roll, for example);
 - Subject of agreement is a product "popular" with tax defrauders (software, optical elements, plastic dies, etc);
 - Individuals that are recipients of payment under import foreign trade agreements return a part of funds to the country, to legal entities and individual entrepreneurs' accounts as a payment for legal, accounting, marketing services or remittances in favor of private individuals.

Suspiciousness indicator group 3 (with regard to other data and documents accompanying foreign trade contracts execution):

- Sham or false contracts as transactions grounds;
- Participation of a “shell-company” in the framework and lack of available data about the company’s real activity in the country of registration as an economic entity;
 - Documents submitted to the financial institution for settlements under a foreign trade transaction turned out to be forged or have essential drawbacks from the legal point of view, contain contradictory data (for example, mismatching data about non-resident’s account in the contract and in the specification)
 - Primary confirmation of delivery by different companies that take part in the framework is being formalized on the same day;
 - Goods import and export falsification;
 - Declared goods value at the customs of different countries in the course of goods export and import;
 - Lack of data about the company’s operational activities;
 - Lack (no confirmation) of information about goods delivery.

It is worthwhile to say that the mechanisms and methods listed above contain complex, intricate, multi-level operations. Moreover, they are varied, may be combined and have national characteristics that depend on conditions of legislative limitations, etc.

Taking into account the results of the carried out typological study of the Belarusian FIU, the following parameters, according to which foreign economic activity risks should be assessed and which are presented in a structured fashion in Appendix 3, can be pointed out.

When carrying out foreign trade transactions for money laundering, the following instruments are used:

- Export and/or import artificial transactions;
- Contracts containing misleading information;
- Legal entities and their accounts;
- Dummy companies, dummy-featured businesses (residents and non-residents);
- Bank giro transfers;
- Offshore companies;
- Disposable funds, bills of exchange and (“trash”) securities;
- Fictitious credits;
- Lost, forged ID documents.

The main money laundering mechanism in foreign trade transactions determined in the previous typological study is conclusion of sham sale and purchase contracts.

Other widespread money laundering mechanisms are the following:

- Submission of documents containing misleading data to a customs officer;
- Non-declaring or declaring of goods not according to their items;
- Discrepancy between declared and actual quantity of goods;
- Smurfing – division, structuring of transactions;
- Transit companies;
- Submission of misleading data regarding consignees and import conditions (in case of temporary import);
- Submission of unreliable certificates of goods origin;
- Re-addressing of cargos and “interrupted” traffic;
- Goods withholding from customs control and cargo transfer outside entry point locations.

Detection of “soft spots” in the system structure consisting of business entities, financial intermediaries, a set of normative legal acts regulating this scope of activities, and state bodies controlling foreign economic activity implementation legality, is a pre-requisite for efficient assessment of money laundering risks in foreign trade activities.

It was emphasized in the document, developed by FATF in the June of 2007 under the title “Guidelines on Methods of Combating Money Laundering and Financing of Terrorism, based on Risk Assessment. High Risk Principles and Procedures”, that with view of most efficient use of state resources the competent authorities and financial institutions must accept methods based on risk assessment, which can fully share the Financial Action Task Force Guidelines. This method requires resources and expert evaluation for risk information collection and reasoning, both at the state and institutional level in order to develop control procedures and carry out staff training.

As it was detected in the previous study, the “risky” foreign trade transaction entities, **risk companies**, are the parties to and agents of foreign trade transactions structured in Appendix 4.

Territories (countries), that are used or can be used potentially for money laundering, can be pointed out with respect to the subject of our study. These countries traditionally include offshore jurisdictions, countries with favorable tax regime, countries with underdeveloped financial control system.

Additionally, attention must be paid to the **risk countries**, i.e. countries participating in narcotic drug production and traffic; countries contributing to extremist organizations; countries not cooperating within the field of anti-money laundering and combating terrorist financing.

For instance, based on the data from the FIU of the Republic of Armenia it is possible to conclude that external turnover with offshore countries makes a quite large share in the total turnover of the state, compared to the countries bordering on the Republic of Armenia.

Indicator Year		2007	2008	2009
		Export	E	1,196.6
E ^o	339.4		252.0	134.4
E ⁿ	129.4		108.2	73.1
e ^o	28		23	19
e ⁿ	11		9	9
Import	I	2,796.9	3,775.5	2,817.2
	I ^o	607.4	752.1	498.5
	I ⁿ	413.4	641.0	454.6
	i ^o	22	20	17
	i ⁿ	15	17	16

Where:

E - absolute export value in millions USD.

E^o- absolute value of export to offshore countries in millions USD.

e^o- percentage ratio between export to offshore countries and total export volume.

Eⁿ - absolute value of export to bordering countries in millions USD.

eⁿ - percentage ratio between export to bordering countries and total export volume.

I - absolute import value in millions USD.

i^o- absolute value of import from offshore countries and total import volume.

iⁿ - absolute value of import from bordering countries and total import volume.

The same tendency is observed in other countries of the study as well.

The risk assessment coordinator, the financial investigation unit, shall be also in position to trace commodity and money flows.

Country- and region-wise strategic insight based on detection of key characteristics of outbound and incoming commodity flows and data on outbound and incoming cash flows in combination with a structural analysis of financial flows will allow making a well-founded conclusion that cash flows are not associated with actual and legal economic relations and are money laundering channels, including money laundering through sham foreign trade contracts.

Further analyses can include determination of track record, financial anomaly cyclicity, participants' specific characteristics, suspicious financial transaction indicators, etc.

For the purpose of risk management and efficient use of Financial Intelligence Unit resources available for holding investigations, **risk commodities** should be identified for each country in order to determine the sources of proceeds of crime.

Risk commodities are commodities that are transferred across the border, in relation to which risks were determined or there are potential risks of their use for the purposes of making and laundering of proceeds of crime, in accordance with Appendix 5.

2.5. Conclusions by Chapter 2.

At present the importance of understanding money laundering risks and vulnerability is increasing with view to apply appropriate and economically effective strategies for money laundering prevention.

The Risk Assessment Tool is developed as an intellectual tool for decision-making that would help decision-making respondents assess and analyze the money laundering risk in the sphere of a foreign economic activity.

The tool makes it possible to identify vulnerability sources and the inter-relation of various factors that influence the vulnerability level. This tool may be used for multiple observations and analysis of various policy variants on the scenario-basis. For example, actions' influence (individually or collectively) may be determined in order to reduce vulnerability.

Information about key factors that influence money laundering vulnerability is often incomplete. Besides, the money laundering sphere is often complicated. Such situation makes a simplified risk level assessment tool insufficient to evaluate money laundering vulnerability. Subsequently, money laundering and vulnerability assessment tool uses a confidence network (or Bayesian network) to determine the dependence of different variables.

The model assesses the expected risk and vulnerability on the probability estimate basis. The Bayesian network-based tool is especially good for the situations when qualitative and quantitative data have to be combined. Besides, the tool helps the user identify information and knowledge gaps. Model's precision increases and enhances risk analysis efficiency as far as such gaps are being taken into account step by step.

Using the Risk Assessment Tool it's practical to define the state and the function of system in compliance with FATF Guidelines and compare state indices from this point of view.

The second part of the tool enables to determine money-laundering risks through foreign trade operations thus classifying these risks. Besides, there is an option to determine the share of **risk companies**, **risk countries** and **risk commodities** in the total volume of foreign trade transactions.