



APPENDIX D

Trade-Based Money Laundering and Terrorist Financing

Trade-Based Value Transfer

Criminally-minded individuals and organizations have long misused international trade mechanisms to avoid taxes, tariffs, and customs duties. As both the formal international financial system and informal value transfer systems become increasingly regulated, scrutinized, and transparent, the risk of criminal money launderers and terrorist financiers attempting to use fraudulent trade-based practices in international commerce to launder, move, and use funds also increases.

Trade-based value transfer schemes use commerce in licit or illicit goods to transfer value. For example, under-invoicing a shipment of trade goods from country A to country B provides a simple and effective way to launder the proceeds of criminal activity. Over-invoicing a shipment of goods gives criminal organizations a paper rationale to send payment abroad and/or launder money. Thus, if a container of electronics is worth U.S. \$ 50,000, but is over-invoiced for U.S. \$ 100,000, the subsequent payment of U.S. \$ 100,000 will cover both the legitimate cost of the merchandise (U.S. \$ 50,000) and allow an extra U.S. \$ 50,000 to be remitted or laundered abroad. The business transaction and documentation disguise the illicit transfer of \$50,000, and wash the money clean. Informal Value Transfer Systems (IVTS) frequently make use of invoice manipulation as part of a scheme to transfer value between IVTS operators.²⁴

There are a number of other types of invoice fraud and trade techniques. For instance, export incentives often encourage and disguise fraud. In this scheme, governments pay company cash incentives to export products, and the company uses the same export to launder money. In some countries, traders report to exchange control authorities that imports cost more, or exports

less, than the actual value. The excess foreign exchange generated can be used to purchase additional foreign trade items. In some areas of the world, trade goods (including narcotics) are simply bartered for other commodities of value.

The simple schemes described above can become more complex when the misuse of trade also involves traditional and entrenched ethnic trading networks, indigenous business practices, smuggling, corruption, narcotics trafficking, the need for foreign exchange, capital flight, terrorist financing, and tax avoidance. Frequently, many of these elements are co-mingled and intertwined, making it extremely difficult for criminal investigators to follow the trail.

Trade-based money laundering can also be viewed as a component of other types of alternative remittance systems, such as *hawala*, the Black Market Peso Exchange,²⁵ and the use of precious metals, gems, and other commodities. Alternative remittance systems, sometimes referred to as IVTS, can be problematic because they use parallel banking, or underground banking and move money or transfer value without necessarily using the regulated financial industry. In all of these alternative systems, trade is most often the vehicle that provides "counter valuation" or a method of "balancing the books."

Trade-based value transfer is prevalent in many parts of the world that harbor terrorist groups and that are vulnerable to terrorist financing because of loose financial regulation and lax import/export laws and regulations. At present, it is difficult for law enforcement to interdict suspect transactions in this underworld of trade. At times, however, trade-based systems intersect with banks and other traditional financial institutions in order for the terrorist financiers or non-terrorist money launderers to obtain currency needed

²⁴ *U.S. v. Shakeel Ahmad*, 231 F.3d 805 (2000) (cert. denied Nov. 27, 2000.)

²⁵ The Black Market Peso Exchange is extensively discussed in Goal 1, see fn. 8.

to purchase goods for further fund transfer, or because the financial institutions serve as links in a clearing process that involves wire transfers.²⁶ Where trade-based money laundering/terrorist financing intersects with financial institutions, law enforcement may be able to identify the brokers or their representatives. Moreover, at that point, financial institutions may be able to review the trade-related financial transactions for indications of unusual activity, which may be reported to authorities in suspicious activity reports.

In this regard, it is important for law enforcement officials to assert a much more aggressive role in recognizing and investigating how trade can be used in money laundering and in the financing of terrorism. It is also essential that government authorities take active measures to make financial institutions aware of the ways IVTS operations may intersect with their institutions, so that they can better monitor and report on these activities.²⁷

Recent money laundering cases involving International Emergency Economic Powers Act (IEEPA) violations demonstrate the use of commodities or goods to facilitate the transfer of value to OFAC-blocked countries.²⁸ In these cases, IVTS operators accept cash from expatriates in the U.S. and, using informal alternative remittance system mechanisms, transfer the funds abroad where the money is used to purchase miscellaneous goods, (medicine, food, etc.) for family members and friends located in the OFAC-blocked country. In many of these cases, funds are transferred through third parties outside the OFAC-blocked country, who further transfer the funds/value to the OFAC-blocked country, in the form of local currency or goods.

Trade Diversion Schemes

Trade diversion schemes create hard-to-detect value transfers that not only launder dirty money, but also themselves provide quick illegal profits. For example, a foreign front company may purchase legal goods from a legitimate U.S. company at a significant discount (up to 50%);²⁹ pay through a letter of credit, send the goods via an intermediary in a third country, and divert (i.e. return) the goods back to the United States, where they are sold to wholesalers at a higher price, but at an amount that still represents a discount (e.g., 20%) for the new buyer. The seller in this latter transaction (e.g., an intermediary front company associated with a criminal operation) then receives the proceeds of a legal sale. If a front company purchases \$1 million worth of goods at a \$500,000 discount and re-sells them for \$800,000 a few weeks later through a trade diversion scheme, the mechanism can generate a \$300,000 profit in apparently clean funds that anyone can use.

Gold, Gems, Diamonds, and Trade

Trade in gold, diamonds, and other precious metals and gems have long been associated with money laundering. Terrorist organizations around the world have also used gold and the trade of precious commodities to launder money or transfer value. Since our success in establishing international anti-money laundering/counter-terrorist financing standards is bringing about an increase worldwide in financial transparency, the underworld of gold and other precious metals and gems may increasingly be used as an alternative method of laundering illicit proceeds or moving terrorist-related funds.

²⁶ A recent Congressionally-mandated study conducted by Treasury/FinCEN on ARS revealed that some domestic-based ARS operators maintain bank accounts for various purposes, including managing ancillary businesses; conducting aggregate wire transfers; and acquiring monetary instruments for bulk shipment overseas to settle payments with counterpart ARS operators. The study cites an example in which a domestic-based ARS operator wired money to an overseas account, after which the funds were withdrawn to purchase commodities that were shipped to another overseas location, where they were sold. Proceeds from those sales were put into a bank account maintained by an overseas ARS operator, and used to pay the ultimate beneficiaries.

²⁷ See FinCEN Advisory on Informal Value Transfer Systems, Issue 33, March 2003.

²⁸ *U.S. v. Hussein Alshafei, et al.*

²⁹ A U.S. company may be willing to sell goods to a foreign company at a discount in order to open up a particular market for the U.S. company overseas. The foreign company purchasing the discounted goods may, unknown to the U.S. company, be a front for a criminal operation seeking to launder funds, as well as to gain a profit through a trade diversion scheme.

There are many reasons that gold is popular with money launderers. It has been a universal repository of wealth since antiquity; is a readily acceptable medium of exchange around the world; enjoys relatively constant value; offers easy anonymity; is portable; its form can be readily altered; trade in gold is easily manipulated; cultural reasons ensure a constant demand for gold; and, depending on the form of the gold, it can act as either a commodity or a *de facto* bearer instrument. Gold is used in all stages of money laundering—placement, layering, and integration. It is an alternative remittance system by itself, and is also an integral part of other alternative remittance systems, such as *hawala* and the black market peso exchange. Although almost any trade item can be used to launder money,³⁰ gold is particularly attractive to money launderers because it has less bulk than many other commodities, and a relatively constant high dollar value.

Because of gold's unique properties, it is also a well established vehicle to help finance terrorist operations. For example, the right-wing Posse Comitatus in the United States, the Aum Shinri Kyo cult in Japan, and Colombian narco-traffickers have all used gold.

Gold is also emerging as a base for Internet digital currency transactions. One Internet business is using gold-backed currency, making it the world's first hundred percent precious metal-backed Internet (digital) currency businesses.

Gems such as emeralds and tanzanite are also linked to money laundering and terrorist financing. For example, much of the trade in emerald gemstones identified as originating in Pakistan actually originates in Afghanistan. The gems are often traded through Mumbai and Jaipur, India, with the resulting sale revenue going directly to Dubai, where it is traded for gold bullion that goes back to India, where it is used to make jewelry for export – i.e., another trade-based vehicle. Similarly, gemstone auctions in Burma are used to launder narcotics proceeds. There are also reports that tanzanite, mined only in northeastern

Tanzania, is smuggled through ports in East Africa to bazaars in the Middle East, where the black market trade in these gems is susceptible to manipulation by money launderers and those that help finance terrorism.

The extra-legal trade of diamonds in Africa often involves money laundering for criminal and political purposes, and provides a means to purchase arms and influence the political arena. "Blood diamonds" is the term used to describe the diamond trade that has helped finance African civil wars in Angola, Sierra Leone, Liberia, and other countries.

There have been press and other media reports³¹ that the diamond trade is also being used for terrorist financing operations. The diamond trade in Africa is susceptible to terrorist financing exploitation through cross-border trade that uses established diamond trade routes, secondary level traders and agents, and suspect buyers. Diamond traders in Africa are often non-African. Operating from secured compounds, expatriate buyers, including those with terrorist links, often purchase rough diamonds via local currency. (Although purchases occur in local currency, the diamond trade utilizes U.S. dollars at all levels of commerce including the payment to buyers). Subsequent exports by the diamond buyers to the major diamond trading centers are often under-valued. Diamonds are also used to provide counter valuation in *hawala* transactions. Many of the diamond buyers involved with illicit diamond dealing in West and Central Africa pay protection money to groups identified as terrorist organizations.

³⁰ Many other commodities with universal value (e.g., medical equipment; alcohol; tobacco; construction material; etc.) are just as vulnerable to being used for money laundering and value transfer. Terrorist financiers, for example, can raise funds to support terrorism by exporting any kind of commodity or good that has value and use in the receiving country. Such transactions can be ad hoc, as opposed to repeated and regular, and mixed in with other trade transactions, making the activity even harder to detect.

³¹ Associated Press, *Group That Tracks Financing of Terrorists to Double in Size*, LA Times, Jan.10, 2003 at A20.