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ICC publishes new papers on financial crime risk control

Financial crime risk control remains a great challenge for financial institutions as they often have limited time and resources to identify and manage associated risks in providing trade finance to businesses. Implementing robust controls and risk-based approaches in handling these transactions are essential.

In relation to this, the International Chamber of Commerce (the "**ICC**") has recently published two papers which provide updated discussions on (i) dual-use goods and proliferation financing¹ (the "**Dual-use Goods Paper**") and (ii) price checking of goods and services in trade transactions² (the "**Price Checking Paper**") (together the "**ICC Papers**"). The ICC Papers are mainly directed at financial institutions, but the comprehensive analyses therein are equally applicable to any participant in the trade business.

Dual-use Goods ("DUG")

DUG are defined as items having both commercial and military or proliferation applications. They are usually subject to a variety of export restrictions and controls set by national and/or international agencies, mostly in the form of sanctions or licensing requirements.

As the Dual-use Goods Paper highlights, the fundamental challenge for financial institutions in handling trade finance transactions involving DUG is the identification of DUG in the first place, and specific challenges include:

- 1) the difficulty in interpreting the nature of descriptions provided by governments/regulatory bodies;
- 2) the technical nature of goods and challenges for non-expert processing staff;
- 3) the lack of standardisation and ability to use lists in automated screening;
- 4) false positive rates;

5) incomplete goods descriptions; and

6) deliberate obfuscation.

In our view, these challenges could be further traced back to a single root – insufficient knowledge, information and standards for practitioners to identify DUG effectively and efficiently.

Main issues with DUG screening

The technical nature of DUG and the technically-detailed control lists prescribed by governments mean that it will almost be impossible to understand the varying applications of DUG without the necessary technical qualifications and knowledge across a wide range of products and goods. Excessive counts of false positives reported by financial institutions demonstrate the difficulties in screening for DUG.

On a transaction level, DUG may be described in generic terms with many uses (e.g. "pumps") or specific terms with more detailed descriptions including advance features and other technical aspects (as might be required for a pharmaceutical

¹ ICC (2023), Financial crime risk controls – Dual-use goods and proliferation financing. <https://iccwbo.org/news-publications/policies-reports/global-trade-receivables-finance-mitigate-proliferation-financing/>.

² ICC (2023), Financial crime risk controls – Price checking of goods and services in trade transactions. <https://iccwbo.org/news-publications/policies-reports/financial-crime-risk-controls-price-checking-of-goods-services-in-trade-transactions/#:~:text=ICC%20recognises%20the%20challenges%20faced,fund%20transfers%20through%20price%20misrepresentation>

active ingredient, for example) in the trade transaction documentation submitted to financial institutions. The absence of detail or, at times, too much detail makes complex analytics or simple matching logic very difficult to productively achieve – not to mention that bad actors may deliberately mis-describe the DUG to confuse financial institutions.

A lack of standard universally applicable list of DUG also creates a hurdle for financial institutions to efficiently exercise crime-risk control. These lists often vary across different countries, making it difficult for financial institutions to adopt automated screening, resulting in ineffective and insufficient initial identification processes.

Approaches to DUG screening

With the above challenges in mind, the Dual-use Goods Paper explores the best approaches to screen DUG. To start with, manual review based on a risk-based approach remains the industry practice. Keeping a team of well-trained employees with knowledge of the risk associated with DUG and proliferation financing will build a solid foundation for screening efforts.

Goods list-based screening and name screening are also common. In the long run, third-party vendors with new offerings on automated detection enabled by emerging technology is expected to be a driver of new screening approaches. A typical technology solution incorporates, among others, automation relative to the extraction of goods description from documents, standardisation through conversion to universally applicable goods classification, validation against maritime intelligence and technology-driven analytics. Social analytics and big data techniques are also expected to be new weapons in the arsenal which could expose transactions with unusual payment flows and/or shipping corridors.

Recommendations

The Dual-use Goods Paper reminds financial institutions of the need for training and raising awareness among employees in relation to DUG and proliferation financing risk control. Financial institutions are expected to adopt a risk-based approach, employ enhanced due diligence on customers with high risk profiles and business types and pay attention to high risk entity lists with greater exposure to proliferation financing.

Price checking

The Price Checking Paper explores the challenges associated with the implementation of controls in relation to price misrepresentation risk in trade finance transactions and relevant industry practices.

Main issues with price checking

It is observed that financial institutions generally are not able to make meaningful determinations about the legitimacy of unit pricing due to the lack of relevant business information. Business relationships, volume discounting and quality of the goods involved are all factors which may affect prices. The collection of objective information such as historical transaction data only provides limited assistance, as time, trade Incoterms, quality and product nuances and bargaining positions of parties across industries could all be legitimate reasons supporting price variations. Even a specialist team could foreseeably be impacted by inherent limitations of price checking which are pertinent to the financial industry.

Approaches to price checking

The Price Checking Paper points out that manual review of trade finance transactions remains the most prevalent method in identifying price misrepresentation. This is commonly coupled with price checking for commodities which are traded on the financial markets and for which prices are available to a reasonable degree of accuracy, but reliable price references may only be available for certain commodities.

As collusion is seen as instrumental for price misrepresentation and typically manifests through common ownership between buying and selling entities, an observation is that the development of post-transaction automated monitoring solutions using social network analytics and big data techniques to identify ownership structures might address such risks. In fact, third-party vendors have developed certain technologies in the field to identify DUG and also broader trade-based financial crime concerns including pricing anomalies, but the associated costs and levels of success make it challenging for financial institutions to adopt these solutions.

Recommendations

The Price Checking Paper ends by admitting that manual price checking has a reasonable degree of accuracy for some commodities for which published market prices exist, and added that financial institutions may consider engaging with third-party vendors to explore the use of new technologies aimed towards the automated detection of higher risk patterns visible through implied collusion between socially connected entities.

Observations

DUG and price checking are not new issues faced by market participants in the trade finance industry. While a one-size-fits-all solution has not been found, it would be prudent for financial to review their risk-control mechanisms regularly, particularly their approach in dealing with "information", which is a term pervasive in the ICC Papers. Excessive information creates no less problem than the lack of information, and deliberately manipulated and misleading information remains an ever-present risk.

Lastly, technology is playing a bigger role in financial crime risk control. It allows financial institutions to discover patterns and relationships, but the human element remains essential to make any sensible determinations. For this reason, financial institutions would be well advised to train and maintain a team of professionals with a risk mindset and industry knowledge which might hopefully be gained over time.

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