

The Wolfsberg Trade Finance Principles

1. Preamble

These Principles form part of broad-based and ongoing industry efforts to define standards for the control of the AML risks associated with trade finance activities¹. The Wolfsberg Group² has published these Principles on the role of Financial Institutions (FIs) in relation to the management of processes:

- To address the risks of money laundering and terrorist financing (collectively referred to as AML) through certain trade finance products. Whilst this paper addresses the risks of both money laundering and terrorist financing, it should be noted that what FIs can do with respect to the latter is limited. See Section 4(c) of this paper.
- To aid compliance with international and national sanctions, including the Non Proliferation of Weapons of Mass Destruction (NPWMD) requirements of the United Nations (UN).

2. Background

Trade finance can, in its broadest interpretation, be described as being the finance by FIs of the movement of goods and services between two points, both within a country's boundaries as well as cross border. Trade finance therefore encompasses both domestic as well as international commerce.

Trade Finance activities comprise a mix of money transmission conduits, default undertakings, performance undertakings and the provision of credit facilities. All FIs involved in the finance of trade should have adopted risk policies and controls which are appropriate for their business.

Historically trade finance has not been viewed as a high risk area in relation to money laundering. This perception has changed of late and increasingly regulators and international bodies view trade finance as a "higher risk" area of business for money laundering, terrorist financing and, more recently, for transactions related to the potential breach of international and national sanctions, including the proliferation of WMD. The Wolfsberg Group is committed to the application of appropriate systems and controls in respect of trade finance products to mitigate these risks. It does not however believe that currently there is sufficient evidence to support an assessment of this area as high risk for AML/Sanctions purposes.

It should be recognised however that the majority of world trade (approximately 80%) is now carried out under "Open Account" terms. This means that the buyer and seller agree the terms of the contract, the goods are delivered to the buyer who then arranges a clean payment, or a netting payment, through the banking system. In these circumstances, unless the FI is providing credit facilities, the FI will only see the clean payment and will not be aware of the underlying reason for the payment. The FI has no visibility of the transaction and therefore is not able to carry out anything other than the standard AML and Sanctions screening on the clean/netting payment. Where the FI is providing credit in relation to the trade transaction there may be more opportunity to understand the underlying trade and financial movements.

¹ Recent efforts on this front include the FATF's "Best Practices Paper on Trade Based Money Laundering" [June 2008]

² The Wolfsberg Group consists of the following leading international financial institutions: Banco Santander, Bank of Tokyo-Mitsubishi-UFG, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Société Générale and UBS

Whilst the FATF Best Practices paper mentioned as footnote 1 defines trade finance to include non-documentary trade activities (e.g. management of open account trading), the definition of trade finance contemplated by this Principles Paper is narrower in scope.

For the purposes of this paper, the term trade finance will be limited to those standard products used for the finance of the movement of goods or services across international boundaries. The products are Documentary Letters of Credit (LCs) and Documentary Bills for Collection (BCs). Although LCs and BCs can also be used domestically, this remains prevalent only in non OECD countries. These standard products have trade related documents (invoices, transport documents etc) that are sent through FIs and are examined by the FI for consistency with the terms of the trade transaction. Both these products are governed internationally by sets of rules of practice issued under the auspices of the International Chamber of Commerce (ICC) in Paris³. These Rules and the standard international banking practice they have created affect the ways that FIs can follow AML, Sanctions and NPWMD requirements.

It is important to recognise the important and respective roles of the ICC and FIs in promoting international commerce and free trade by supporting the timely and efficient movements of goods, documents and payments. Applying additional or more onerous requirements to importers and exporters in relation to these products may in fact be counter productive and provide additional incentive to avoid these products, which may lead to an increase in “open account” transactions and therefore to less transparency.

The paper will not address other products/services associated with the financing of trade such as vendor financing or structured trade finance involving the use of export credit agency services, insurance or forfait transactions. It is however anticipated that further guidance will be given in relation to these products/services by appropriate additions to appendices as appropriate. Furthermore it is not proposed to cover the management of other risks that may be present, in particular fraud.

3. The Role of Financial Institutions

One of the basic tenets of trade finance, codified in international standard banking practice through the ICC sets of rules, is that “Banks deal with documents and not with goods, services or performance to which the documents may relate”. Banks do not get involved with the physical goods nor do they have the capability to do so. This overarching principle is the basis for defining what degree of scrutiny and understanding a FI can bring to the identification of unusual activity involving a trade finance transaction.

All international trade finance transactions involve FIs in different locations, acting in a variety of capacities. For the purpose of LCs these may include an Issuing Bank, an Advising Bank, Negotiating Confirming Bank or Reimbursing Bank. For BCs there will be a Remitting, Collecting or Presenting Bank. The nature of the capacity in which an FI may be involved is important as this will dictate the nature and level of information available to the FI in relation to the underlying exporter/importer, the nature of trade arrangements and transactions. The fragmented nature of this process, in which a particular FI accordingly has access only to limited information about a transaction, means that it is not possible for any one FI to devise hard coded rules or scenarios, or any patterning techniques in order to implement a meaningful transaction monitoring system.

³ The relevant ICC Rules are: for LCs “The Uniform Customs and Practice for Documentary Letters of Credit (2007 Revision), ICC Publication No. 600 and “The Uniform Rules for Collections, ICC Publication No. 522”

4. Money Laundering/Terrorist Financing

(a) Risks

Despite the fact that historically trade finance has not been viewed as high risk it has always been recognised that international trade and the processes and systems that support it are vulnerable to abuse for the purposes of money laundering and terrorist financing. In recent years, however, the focus on these risks has increased for a variety of reasons, including the dramatic growth in world trade. In addition, the fact that controls introduced by FIs in response to the more traditional money laundering techniques have become more robust means that other methods to transmit funds, including the use of trade finance products, may become more attractive to criminals. FATF have identified these risks in the widely defined area of Trade Based Money Laundering⁴. It is important to note that these studies highlight the fact that the problem is not limited to the trade finance activities in which FIs are directly involved but that any process to move money through the banking system by simple payment may be dressed up as a means of financing trade in order to disguise the true underlying (and potentially illegal) activity. These studies also highlight the importance of the roles of all stakeholders, not just FIs.

The use of trade finance to obscure the illegal movement of funds includes methods to misrepresent the price, quality or quantity of goods.

Generally these techniques rely upon collusion between the seller and buyer since the intended outcome from the arrangements is obtaining value in excess of what would be expected from an arms length transaction. The collusion may well arise because both parties are controlled by the same persons. The transfer of value in this way may be accomplished in a variety of ways which are described briefly below:

Over Invoicing: by misrepresenting the price of the goods in the invoice and other documentation (stating it at above the true value) the seller gains excess value as a result of the payment.

Under invoicing: by misrepresenting the price of the goods in the invoice and other documentation (stating it at below the true value) the buyer gains excess value when the payment is made.

Multiple invoicing: by issuing more than one invoice for the same goods a seller can justify the receipt of multiple payments. This will be harder to detect if the colluding parties use more than one FI to facilitate the payments/transactions.

Short shipping: the seller ships less than the invoiced quantity or quality of goods thereby misrepresenting the true value of goods in the documents. The effect is similar to over invoicing

Over shipping: the seller ships more than the invoiced quantity or quality of goods thereby misrepresenting the true value of goods in the documents. The effect is similar to under invoicing.

Deliberate obfuscation of the type of goods: parties may structure a transaction in a way to avoid alerting any suspicion to FIs or to other third parties which become involved. This may simply involve omitting information from the relevant documentation or deliberately disguising or falsifying it. This activity may or may not involve a degree of collusion between the parties involved and may be for a variety of reasons or purposes.

Phantom Shipping: no goods are shipped and all documentation is completely falsified.

⁴ FATF Typologies report on Trade Based Money Laundering (June 2006)

Making a determination as to whether over-invoicing or under-invoicing (or any other circumstances where there is misrepresentation of value) may be involved cannot be based on the trade documentation itself. Nor is it feasible to make such determinations on the basis of external data bases; most products are not traded in public markets, and there are therefore no publicly available market prices.

Even in transactions involving regularly traded commodities subject to publicly available market prices, FIs generally are not in a position to make meaningful determinations about the legitimacy of unit pricing due to the lack of relevant business information, such as the terms of a business relationship, volume discounting, specific quality of the goods involved, etc.

Moreover, notwithstanding that in certain limited circumstances FIs may gain some of this business information, it would be reasonable for them to do so only in the specific, highly-structured transactions at issue rather than generally.

However, there may be situations where unit pricing appears manifestly unusual, which should prompt appropriate enquiries to be made.

(b) Assessment of Risks

As with their other lines of business, services and products, FIs should apply a risk based approach to the assessment and management of risk in relation to trade finance. In this connection the Wolfsberg Group has issued general guidance on a Risk Based Approach which is considered relevant in the context of trade finance.

The assessment of risk and application of appropriate AML controls will also depend on the role of an FI in any trade transaction.

As trade finance transactions may involve a number of FIs there will be a considerable degree of apportionment between these institutions in respect of their responsibility to conduct underlying due diligence on their respective customers. A number of these FIs may be correspondents of one another and therefore the principles espoused in the Wolfsberg AML Principles for Correspondent Banking will be relevant.

(c) Application of controls

FIs review trade transactions on an individual basis. Generally transactions are examined for the application of the ICC rules referred to above and for their workability in terms of whether the conditions as documented conform with international standard banking practice as well as what is known of the customer. This review is used to examine the transaction not only for fraud but also for unusual and potentially suspicious activities. The complex paper based nature of these transactions provides a large amount of information about the parties, goods and services being transferred and involves scrutiny of the relevant documents. Whilst certain elements of this process may be automated (e.g. screening of transactions against published lists of sanctioned entities) the overall process of reviewing trade documents by its nature cannot be successfully automated.

Such controls are relevant in the context of anti-money laundering and counter-terrorist financing efforts (but only to the extent that terrorist financing involves criminal activities/money laundering). The most effective means by which to identify terrorist involvement in trade finance transactions is for competent authorities to identify those individuals and organizations connected to terrorist activities and provide that information to FIs in a timely manner. Accordingly, trade finance controls consisting of screening part of the transactional information against lists of known or suspected terrorists issued by competent authorities having jurisdiction over the relevant FI are relevant in the context of anti-terrorist financing efforts.

More specific guidance with regard to the nature and extent of controls that should be applied by the various FIs in relation to the underlying parties to the transaction and the documentation are set out in the appendices. Appendix (I) deals with LCs and appendix (ii) deals with BCs.

5. Sanctions and Non Proliferation Weapons of Mass Destruction (NPWMD)

(a) Risks

There are a variety of United Nations (UN) and national or regional sanctions in place. These include:

- Country based financial sanctions that target specific individuals and entities
- Trade based sanctions e.g. embargos on the provision of certain goods, services or expertise to certain countries.

In recent years there has also been a series of UN Security Council Resolutions which have inter alia introduced targeted financial sanctions and/or activity-based financial prohibitions in respect of certain countries which relate to the prevention of WMD proliferation.

Compliance with the sanctions in force within jurisdictions is relevant in relation to all the products and services offered by an FI. Sanctions that require the embargo of certain goods and services have particular relevance in relation to the provision and facilitation of trade finance products.

International trade is an enormous global endeavour, both in terms of monetary value as well as the volume of transactions, involving trillions of dollars and millions of individual transactions of relatively small monetary value. The ability of any one FI to understand who the ultimate buyer (or seller) of a product is, or what the ultimate end use of that product may be, is severely limited. This understanding will be even more limited where transactions are part of a complex structure.

It is recognised that in the area of activity based-sanctions relating to WMD a considerable amount of research and consultation between all interested parties in the public and private sections is required. This collaboration will help to develop legislation/regulation as well as the provision of guidance to FIs and implementation of commensurate controls. The Wolfsberg Group supports continuing dialogue between all relevant stakeholders as set out in section 6 of this paper.

(b) Risk Assessment

The greatest risk involved in relation to breach of sanctions and the proliferation of WMD is the use of intermediaries and other means to hide the ultimate end user of a product, or the ultimate application/use of a product. Transactions involving multiple parties and transfers of ownership may disguise the true nature of a transaction.

The use of trade finance for breach of sanctions and/or the proliferation of WMD could potentially take advantage of the complex and fragmented nature of existing global finance activity where multiple parties (many times unknown to one another) become involved in the handling of trade finance.

(c) Application of Controls

The application of existing and appropriate AML controls is also considered relevant for the purpose of complying with sanctions and NPWMD.

More specific guidance with regard to the nature and extent of controls that should be applied together with a description of the limitations faced by FIs are set out in appendix (iii).

6. National and Global Co-Operation

There has already been discussion and debate between relevant stakeholders at both a national and international level to counter the threat of money laundering in the trade finance area.

The need for ongoing co-operation is considered even more critical in respect of ensuring that breaches of targeted and/or activity based sanctions are not facilitated through trade finance activities.

Stakeholders may include national bodies such as Governments, Law Enforcement Agencies, Financial Intelligence Units, Regulators, Export Credit Agencies, Customs and Excise, Tax Authorities, Shipping Agents, Carriers, Port Authorities, as well as international agencies such as the ICC Task Force on Money Laundering and FATF.

The Wolfsberg Group has identified the following areas for further consultation and/or the introduction of appropriate controls and this co-operation will aid the contribution FIs are able to make and will enhance controls more generally.

- The provision and maintenance by relevant government authorities of up to date suitably standardised lists of sanctioned entities and individuals, including appropriate biographical and other relevant information to facilitate (a) effective screening and searching against customer data bases and (b) efficient and effective screening of transactions by FIs.
- The provision of details by relevant government authorities in a manner that can be understood by non experts in respect of products and materials that may have “Dual Purpose” properties. These details should ideally be capable of being integrated into electronic processing systems.
- The availability of “Help Desks” within relevant government authorities to respond to queries of a technical nature in relation to sanctions and in particular Dual Purpose goods. Such responses must be timely enough to not adversely impact the bank’s obligations under the trade transaction or alert potential perpetrators.
- Co-operation by the relevant agencies, including enforcement agencies regulators etc, at an international level to permit greater uniformity in relation to the application of AML, Sanctions and NPWMD regimes.
- The publication by the relevant authorities of the names of individuals and entities that have been denied export licences or who have been involved in criminal activities, including corruption, involving trade finance.
- The continuation of dialogue between the public and private sectors in relation to the identification and dissemination of typologies and pre/post event risk indicators in respect of trade finance.

- The provision and maintenance by the authorities of up to date information in respect of the patterns, techniques and routes used by criminals and others to launder money, fund terrorism and breach sanctions in the trade finance area

Wolfsberg Trade Finance Principles Paper

Appendix I

AML Guidance in relation to Letters of Credit (LCs)

(Within this appendix, reference to Banks rather than FIs will be used given the need to refer to Banks in an accepted technical context in relation to LCs)

Introduction

The Trade Finance Principles Paper sets out the background to trade finance and addresses the AML/CTF/Sanctions risks. The paper also comments on the application of controls in general and makes some observations on the subject of future co-operation between relevant stakeholders. This appendix provides guidance on the specific application of controls by Banks in the context of LCs and is intended to reflect standard industry practice. In order to fully illustrate these controls the appendix uses a simplified scenario and then describes in some detail the control activities applied by the Banks involved. Where appropriate, any variations on the simplified scenario will be addressed.

Controls which are described fall into the following broad categories:

- Due Diligence: Used here to describe both the process for identifying and knowing the customer but also for risk based checks in relation to parties who may not be customers. Given the range of meanings applied reference will be made as necessary to “appropriate due diligence” (which may consist of risk based checks only).
- Reviewing: Defined here as any process (often not automated) to review relevant information in a transaction relating to the relevant parties involved, documentation presented and instructions received.. As will also be described under the Risk Indicators section certain information can and should be reviewed and checked before transactions are allowed to proceed.
- Screening: A usually automated process to compare information against reference sources such as terrorist lists. Screening is normally undertaken at the same time as reviewing and prior to the completion of the specific activity subject to review. It may also be undertaken at the same time as, or as part of, due diligence
- Monitoring: Any activity to review completed or in progress transactions for the presence of unusual and potentially suspicious features. For trade transactions it should be recognised that it is impossible to introduce any standard patterning techniques in relation to account/transactional monitoring processes or systems. This is due to the range of variations which are present even in normal trading patterns.

A summary of the key control activities is provided in tabular form at the end of this appendix. For further reference some of the terms used in this guidance are defined in the glossary of terms forming Appendix IV.

It is important to note that with LCs the banks operate in accordance with ICC Publication No. 600 – Uniform Customs and Practice for Documentary Credits. The extent of reviewing activity which banks carry out is determined by their responsibilities as defined within these internationally accepted rules. These rules are fundamentally different to the rules governing Bills for Collection (refer to Appendix II).

Simplified scenario

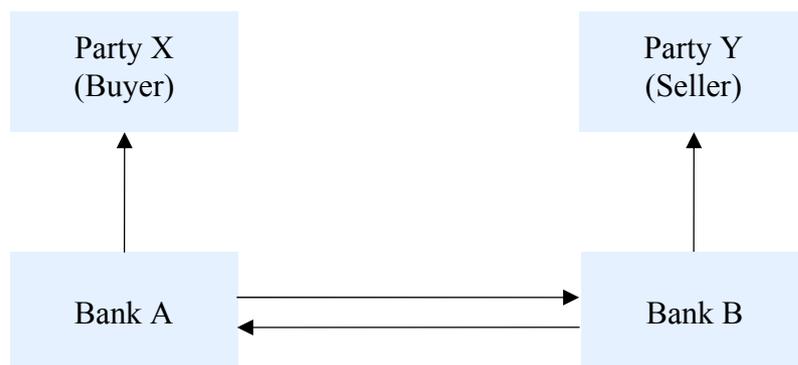
Party X is purchasing goods from one of their suppliers, Party Y. Prior to shipping the goods, Party Y wants to know that they will be paid once the shipment has been made, so Party X arranges with Bank A to make a payment to Party Y's bank, Bank B, only against the receipt of stipulated documents related to the shipment of goods.

Party X instructs bank A to issue an LC in favour of a supplier, party Y. Bank A selects (its correspondent or party Ys nominated) Bank B to advise the LC to Y locally, often in another country. After the presentation of documents by Y through Bank B, and having found the documents to be in order by bank A, Bank A will pay under the LC.

Party X	>>	Bank A	>>	Bank B	>>	Party Y
(Applicant (Importer (Buyer		(Issuing bank		(Advising bank		(Beneficiary (Exporter (Seller

An overview of the due diligence and reviewing activities (which are described in more detail later) is provided in the two flow charts which follow.

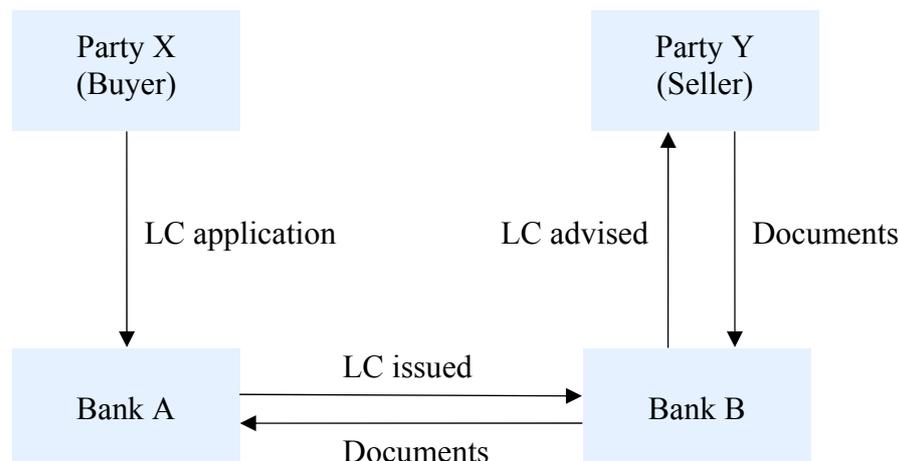
Due Diligence Overview



The banks will conduct due diligence which will normally follow the pattern described below

- Bank A will conduct due diligence on X
- Bank A may conduct appropriate due diligence on Bank B
- Bank B may conduct appropriate due diligence on Bank A
- Bank B will conduct due diligence on Y where Y is B's customer

Reviewing activity overview



Once the LC is initiated by Party X the banks will, in the normal course of LC practice, review the transaction at various stages through to the eventual payment being made. This reviewing activity will normally follow the pattern described below.

- Bank A will review the LC application from X (before agreeing to issue LC)
- Bank B will review the LC as issued when received from Bank A (before agreeing to advise it)
- Bank B may review the documents presented by Y (when accepting them under the LC from Y) applying a risk based approach depending upon its precise role.
- Bank A will review the documents presented by Bank B (before paying B - who will in turn pay Y)
- Bank A and Bank B will review the payment (or other) instructions which they receive

Controls undertaken by Bank A

Party X Due diligence

Bank A should conduct appropriate due diligence (Identification, verification screening, KYC) and credit approval as appropriate on Party X (who is a customer of Bank A) prior to issuance of the original LC. This is likely to involve a series of standardised procedures for account opening within Bank A.

The due diligence will support an on going relationship with party X and is not required for each subsequent LC applied for.

Questions from Bank A that should arise during the due diligence process where LC facilities are required would be expected to establish from party X:

- The countries in relation to which Party X trades
- The goods traded
- The type and nature of parties with whom Party X does business (e.g. customers, suppliers, etc)
- The role and location of agents and other third parties used by Party X in relation to the business (where this information is provided by Party X).

Enhanced Due Diligence

An enhanced due diligence process should be applied where Party X falls into a higher risk category or where the nature of their trade as disclosed during the standard due diligence process suggests that enhanced due diligence would be prudent.

The enhanced due diligence should be designed to understand the trade cycle, and gain assurances related to compliance with cross border customs or licensing regulations, physical controls over the traded goods and the legitimacy of payments flows

The nature of business and the anticipated transactions as described and disclosed in the initial due diligence stage may not necessarily suggest a higher risk category but if, during the course of any transaction any high risk factors become apparent, this may warrant additional due diligence.

This may include third party (i.e. parties not associated with Bank A) middlemen or traders using back to back or transferable LCs to conclude offshore deals.

Where Party X is a middle man or trader, Bank A may consider undertaking enhanced due diligence.

Bank B Due Diligence

Bank A should undertake appropriate due diligence on Bank B. The due diligence may support an ongoing relationship with Bank B which will be subject to a relevant risk based review cycle. Due diligence on Bank B is not therefore required in relation to each subsequent transaction.

In other circumstances Bank A may simply use Bank B as a local processing correspondent in which case due diligence may be conducted on a different basis. As a minimum, Bank A will need to ensure that there is a means of authenticating any message between them.

See the Wolfsberg Correspondent Banking Standards for guidance with respect to the level of due diligence to be performed in relation to Bank B.

Reviewing

Reviewing will occur at initiation and during the life cycle of the LC transaction, principally at the following stages

1. Receiving the initial LC application (and any amendments) from Party X
2. Receiving and checking documents presented by Party Y through Bank B
3. Making payment

In practice, once the LC has been issued the obligation of Bank A is such that the transaction is likely to have to complete without undue delay. After that, only if the reviewing activity in relation to applicable lists relating to sanctions & terrorists creates a “positive match” could Bank A be in a position to stop the transaction.

At stage 2 the documentation presented to Bank A will be examined to ensure compliance with the LC and in accordance with recognised international banking standards. This review will not necessarily need to involve a detailed examination of all the information in all the documentation.

A detailed explanation of potential reviewing activities is set out below

Stage 1 Reviewing the LC application

Appropriate reviewing should be conducted by Bank A in relation to the Letter of Credit application when received from Party X which takes account of the following.

Sanctions & terrorist lists which may affect:

- Directly, Party Y as a named target
- The country in which Party Y is located
- The goods involved
- The country where the goods are shipped from, disclosed transshipment points and destination points.
- Names appearing in the LC

The countries which are rated as high risk for other reasons in which:

- Bank B or Party Y are located
- The transportation of goods occurs

The goods described in the transaction to check that:

- The type, quantity and value of goods is consistent with what is known of Party X
- There are no generally known embargoes other than those arising from sanctions (local law and UN sanctions)

The seller (Party Y) to check that:

- On the face of it they are the kind of counterparty which is consistent with what is known of Party X's business

Indicators of unusual aspects of a transaction (frequently occurring in combination) which may become evident and which (for example) appear to:

- Involve unrelated parties
- Involve highly unorthodox documentation
- Involve a complex structure obscuring the true nature of the transaction
- Involve other parties which as a result of any screening activity Bank A regards as unacceptably high risk
- Create an unusual trigger point for the payment to be made under the LC (e.g. before goods are shipped without the need for relevant documentation.).

Depending on the information arising from this reviewing process Bank A may need to:

- Make further internal enquiries as to the appropriate course of action
- Request more information from Party X before agreeing to proceed with the transaction
- Allow the transaction to proceed but make a record of the circumstances for review purposes where appropriate
- Decline the transaction if enquiries do not provide reasonable explanations, and subject to circumstances and local legal requirements submit a suspicious activity report.

Stage 2 Reviewing the documents presented under the LC

Appropriate reviewing should be conducted by Bank A in relation to the documents presented by Bank B which should take account of the following

- Local legal requirements
- The screening of Bank B and Party Y against current applicable lists

- The extent to which the documents presented comply with the information already checked in the LC, since full documentary compliance would in effect mean that relevant reviewing activities which having already been done once do not need to be repeated.
- The elapse of time between stage 1 and stage 2 since this might raise the need for a further check of any relevant sanctions or binding local regulations

Stage 3 making the payment

When making payment Bank A will screen the names in the payment instructions, including the names of any banks involved. Therefore in the event that Party Y maintained an account with a bank not involved in the LC, that bank's name should be subjected to screening by Bank A.

Monitoring

For Bank A the monitoring opportunities arise from:

- The normal procedures for monitoring Party X's account and transactional activity.
- Party X's activity observed from business as usual trade processing more generally

Limitations faced by Bank A

Bank A will rely heavily on the initial due diligence conducted on party X. It will not be practical or commercially viable for Bank A to continually seek detailed additional assurances from Party X as every new transaction is received for processing because that would a) hamper the efficiency of processing and b) undermine the element of trust which is normal in the relationship between Bank A and Party X

Controls undertaken by Bank B

Due Diligence

It will not normally be practical for Bank B to undertake any due diligence on Party X aside from the reviewing of Party Xs name against sanctions or terrorist lists.

Bank B should undertake appropriate due diligence on Bank A. The due diligence may support an ongoing relationship with Bank A which will be subject to a relevant risk based review cycle. Due diligence on Bank A is not therefore required in relation to each subsequent transaction.

In other circumstances Bank B may simply act as a local processing correspondent in which case due diligence may be conducted on a different basis. As a minimum Bank B will need to ensure that there is a means of authenticating any LC received from Bank A.

See the Wolfsberg Correspondent Banking Standards for guidance with respect to the level of due diligence to be performed in relation to Bank A.

Bank B may have an existing relationship with Party Y in which appropriate due diligence procedures should already have been completed.

However Bank B may not have any relationship with Party Y because Bank A has selected Bank B for its own reasons (e.g. there is an existing correspondent relationship in place between Bank A and Bank B). Alternatively Party Y's own bank may not engage in trade business or the processing of LCs. In this case Bank B will need to undertake certain checks in relation to Party Y as described below.

Furthermore, Bank B may act in a number of different capacities in addition to that of the advising bank as described in the simplified scenario at the beginning of this guidance.

It is important to recognise these different roles as they have a direct bearing on the controls which will apply in the context of checks, (and reviewing and monitoring) undertaken by Bank B in different situations. Furthermore there may be other banks which will of necessity become involved in the transaction before it is fully completed. This is likely to occur as many exporters are multi banked.

The following table illustrates the different roles of Bank B and the checks which may be needed in respect of Party Y

Capacity of Bank B	Checks conducted in relation to Party Y where Y is not B's customer
Advising bank	Name screening party Y
Making payment on behalf of Bank A after handling documents	Name screening party Y Payment will only be made to a bank (which has been name screened) through an established payment channel.
Confirming bank	Name screening party Y Payment will only be made to a bank (which has been name screened) through an established payment channel. Additional checks on Y may be required using a risk based approach.
Negotiating/discounting a presentation under LC	Name screening party Y Payment will only be made to a bank (which has been name screened) through an established payment channel. Additional checks on Y may be required using a risk based approach
Transferring bank	Name screening party Y Payment will only be made to a bank (which has been name screened) through an established payment channel. Additional checks on Y may be required using a risk based approach.
Reimbursing bank – will debit bank A's account to settle the claim from the bank which pays Y	Payment will only be made to a bank (which has been name screened) through an established payment channel.

Bank B may well undertake all these roles if they are required. If another bank is undertaking any of these additional roles then the same checks would be relevant for that other bank.

Additional checks in relation to Bank A or Party Y may be appropriate where higher risk factors become evident. This would be the case whether or not there is an existing relationship with Bank B.

Reviewing

Reviewing may take place principally at 3 stages, i.e. Reviewing the LC issued, reviewing the documents presented and making the payment. .

Stage 1 Reviewing the LC issued

Appropriate reviewing should be conducted by Bank B in relation to the LC when received from Bank A which may take account of the following:

Sanctions & terrorist lists, which may affect:

- Directly, any party as a named target
- The country in which Party X is located
- The goods involved
- The country where the goods are shipped from, any disclosed transshipment points and destination points
- Names appearing in the LC

The countries which are rated as high risk for other reasons in which:

- Bank A or Party X are located
- The transportation of goods occurs

The goods described in the transaction to ensure that:

- The nature of these appears to make sense.
- There are no known embargoes other than those arising from sanctions

The applicant of the LC (Party X) to ensure that:

- As a result of any screening activity Bank B would not regard them as unacceptably high risk.

Depending on the information arising from this reviewing process Bank B may need to:

- Make further internal enquiries as to the appropriate course of action
- Request more information from Bank A (or Party Y) before agreeing to proceed with the transaction.
- Allow the transaction to proceed but make a record of the circumstances for reviewing purposes where appropriate

Stage 2 reviewing the documents presented

Appropriate reviewing should be conducted by Bank B in relation to the documents presented by Party Y which should take account of the following

- The extent to which the documents presented comply with the terms and conditions of the LC and that the documents are consistent among themselves and the information contained therein do not conflict.
- The elapse of time between Stage 1 and Stage 2 since this might raise the need for a further check of any relevant sanctions or binding local regulations
- Whether an unusual payment instruction is given by Party Y.

Depending on the information arising from this reviewing process Bank B may need to:

- Make further internal enquiries as to the appropriate course of action
- Request more information from Party Y before agreeing to proceed with the transaction
- Allow the transaction to proceed but make a record of the circumstances for review purposes

Stage 3 making the payment

When making payment Bank B will review the names in the payment instructions, including the names of any banks involved. Therefore in the event that Party Y is not Bank B's customer, that bank's name should be subjected to sanctions screening by Bank B.

Monitoring

For Bank B the monitoring opportunities arise from:

- The normal procedures for monitoring the activity relevant to their correspondent Bank A. This will be dependent upon the systems in place to measure such activity.
- Where Party Y is Bank B's customer, the normal procedures for monitoring the account and payment activity.
- Where Party Y is not Bank B's customer, activity observed from business as usual trade processing more generally

Limitations faced by Bank B

Bank B is not the originator of the transaction but is requested to act on instructions received from Bank A (although it is not obliged to do so). In accordance with established practice for handling LCs Bank B will have limited time in which to act upon such instructions. Bank B may then receive supplementary instructions from either Bank A or Party Y.

The level of reviewing and monitoring which Bank B may conduct on Bank A, or Party Y in the absence of an existing and established relationship with any of them, will be subject to a risk based approach related to the precise capacity which it is acting. This may be limited to reviewing relevant party names against sanctions or terrorist lists.

Risk Indicators, Pre- and Post-Event

An LC is an independent undertaking issued by a bank on behalf of its customer to support a business transaction between the bank's customer (usually the buyer) and the counterparty (usually the seller). Contract terms will be agreed between seller and buyer and then communicated to the buyer's bank so that the LC can be issued. The terms of each LC reflect a unique combination of factors involving the specific nature of the underlying trade transaction, the nature of the business relationship between the counterparties to the transaction, the nature and terms of the financing arrangement, and the nature of the relationship between the financial institutions party to the financing and payment arrangements.

Since the full execution of each LC transaction is a fragmented process involving a number of parties, each with varying degrees of information about the transaction, it is extremely rare for any one Bank to have the opportunity to review an overall trade financing process in complete detail given the premise of the trade business that banks deal only in documents. Furthermore it is relevant to note that:

- Different Banks have varying degrees of systems capabilities which will lead to industry wide differences in their reviewing abilities
- Commercial practices and industry standards determine finite timescales in which to act.
- In determining whether transactions are unusual due to over or under invoicing (or any other circumstances where there is misrepresentation of value) it needs to be

understood that Banks are not generally equipped to make this assessment. (Please refer also to paragraph 4 (a) of the Principles Paper)

For Banks involved in processing LCs, the knowledge and experience of their trade staff must therefore serve as the first and best line of defence against criminal abuses of these products and services. Reviewing trade documentation is a highly manual process, requiring that the commercial documents that are presented for payment are compared against the terms and conditions of the LC in accordance with the applicable ICC rules and standard international banking practice.

Potentially there are a large number of risk indicators. Against this background it is important to distinguish between

1. Information which must be validated before transactions are allowed to proceed or complete and which may prevent such completion. (e.g., a terrorist name, UN sanctioned entity).
2. Information which ought to be used in post event analysis as part of the investigation and suspicious activity reporting process.

Appended below is a list of the some of the risk indicators which might become apparent in the handling of an LC transaction. This table does not contain the full range of risk indicators which might apply generally across the customer / bank relationship, but is specifically targeted to cover some of the risk indicators related to the processing of an LC transaction. It is also important to note that some risk indicators will only become apparent after the transaction has taken place and will only be known to law enforcement or financial investigation units as part of their formal investigation processes.

Some Risk Indicators

WHAT	WHEN
Activity or information connected with the LC	Pre or post transaction
Deal structures <ul style="list-style-type: none"> Beyond capacity/substance of customer Improbable goods, origins, quantities, destination Unusual complexity/unconventional use of financial products 	PRE or POST
Goods <ul style="list-style-type: none"> Applicable import or export controls regulations may not be complied with 	PRE
Goods <ul style="list-style-type: none"> Blatant anomalies value versus quantity Totally out of line with customers known business 	PRE or POST
Countries/names <ul style="list-style-type: none"> On the Sanctions/terrorist list 	PRE
Countries <ul style="list-style-type: none"> On the Bank's high risk list Any attempt to disguise/circumvent countries involved in the actual trade 	PRE or POST
Payment instructions <ul style="list-style-type: none"> Illogical Last minute changes 	PRE or POST
Repayment arrangements <ul style="list-style-type: none"> Third parties are funding or part funding the LC value (just in time account credits to the settlement account) 	POST
LC patterns <ul style="list-style-type: none"> Constantly amended/extended Routinely cancelled/unutilised 	POST
LC Counterparties <ul style="list-style-type: none"> Connected applicant/beneficiary Applicant documentation controls payment 	PRE or POST
Discrepancies in documents (not necessarily grounds for rejection under UCP600) <ul style="list-style-type: none"> Goods descriptions differ significantly Especially invoice v shipping doc Unexplained third parties 	PRE or POST
Discrepancies waived <ul style="list-style-type: none"> Advance waivers provided Absence of required transport documents Significantly overdrawn LC 	PRE or POST

Summary of key controls described in this guidance on LCs

REVIEWING STAGE	WHO/WHAT IS REVIEWED	AGAINST WHAT	BY WHOM
Account Opening Party X	<ul style="list-style-type: none"> Party X 	Appropriate due diligence	Bank A
LC Issuing request from Party X	<ul style="list-style-type: none"> Party X Party Y/other principal parties Names & Countries Goods type 	<p>Sanctions and terrorist lists</p> <p>Sanctions and terrorist lists</p> <p>Sanctions and terrorist lists</p> <p>Local applicable export control lists if known</p>	Bank A
Bank A issues LC to Bank B	<ul style="list-style-type: none"> Bank B 	Appropriate due diligence	Bank A
Bank B receiving LC from Bank A	<ul style="list-style-type: none"> Bank A Party X Party Y/other principal parties Names & Countries Goods type 	<p>Appropriate due diligence</p> <p>Sanctions and terrorist lists</p> <p>Sanctions and terrorist lists</p> <p>Sanctions and terrorist lists</p> <p>Local applicable export control lists if known</p>	Bank B
LC advising by Bank B to Party Y	<ul style="list-style-type: none"> Party Y 	Appropriate to due diligence – (this will vary depending on whether Party Y is a customer of Bank B and the exact capacity of Bank B)	Bank B
Presentation of documents by Party Y to Bank B	<ul style="list-style-type: none"> New principal parties or countries not mentioned in LC 	Sanctions and terrorist lists	Bank B
Presentation of documents by Bank B to Bank A	<ul style="list-style-type: none"> New principal parties or countries not mentioned in LC 	Sanctions and terrorist lists	Bank A
Payment by Bank A to Bank B	<ul style="list-style-type: none"> Names on the payment instruction 	Sanctions and terrorist lists	Bank A
Payment by Bank B to Party Y	<ul style="list-style-type: none"> Names on the payment instruction 	Sanctions and terrorist lists	Bank B

Wolfsberg Trade Finance Principles Paper

Appendix II

AML Guidance in relation to Bills for Collection (BCs)

(Within this Appendix, reference to Banks rather than FIs will be used given the need to refer to Banks in an accepted technical context in relation to BCs)

Introduction

The Trade Finance Principles Paper sets out the background to trade finance and addresses the AML/CTF/Sanctions risks. The paper also comments on the application of controls in general and makes some observations on the subject of future co-operation between relevant stakeholders. This appendix provides guidance on the specific application of controls by Banks in the context of BCs and is intended to reflect standard industry practice. In order to fully illustrate these controls the appendix uses a simplified scenario and then describes in some detail the control activities applied by the Banks involved. Where appropriate, any variations on the simplified scenario will be addressed.

Controls which are described fall into the following broad categories:

- Due Diligence: Used here to describe both the process for identifying and knowing the customer but also for risk based checks in relation to parties who may not be customers. Given the range of meanings applied reference will be made as necessary to “appropriate due diligence”, which may consist of risk based checks only.
- Reviewing: Defined here as any process (often not automated) to review relevant information in a transaction relating to the relevant parties involved, documentation presented and instructions received. As will also be described under the Risk Indicators section certain information can and should be reviewed and checked before transactions are allowed to proceed.
- Screening: A usually automated process to compare information against reference sources such as terrorist lists. Screening is normally undertaken at the same time as reviewing and prior to the completion of the specific activity subject to review. It may also be undertaken at the same time as, or as part of, due diligence
- Monitoring: Any activity to review completed or in progress transactions for the presence of unusual and potentially suspicious features. For trade transactions it should be recognised that it is impossible to introduce any standard patterning techniques in relation to account/transactional monitoring processes or systems. This is due to the range of variations which are present even in normal trading patterns.

A summary of the control activities is provided in tabular form at the end of this Appendix. For further reference some of the terms used in this guidance are defined in the glossary of terms forming Appendix IV.

It is important to note that with BCs banks operate in accordance with ICC Publication No. 522 – Uniform Rules for Collections. The extent of reviewing activity which banks carry out is determined by their responsibilities as defined within these internationally accepted rules. These rules are fundamentally different to the rules governing LCs (refer to Appendix I)

Simplified scenario

Party X is selling goods to Party Y. Party X is willing to ship the goods but does not want the documents which entitle Party Y to receive the goods to be released until Party Y has paid for them or given specified payment undertakings.

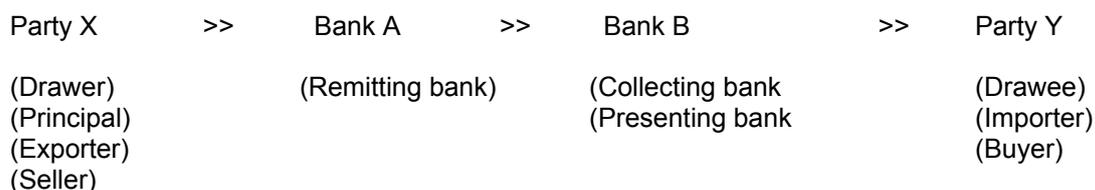
In this scenario it is assumed that Party X is the customer of Bank A and Party Y is the customer of Bank B.

Party X (the seller) instructs Bank A to collect payment in relation to documents drawn on Party Y (the buyer). Bank A selects (its correspondent bank or Party Y's nominated bank) Bank B to present documents for payment to Party Y locally in the other country. The delivery of documents to Party Y by Bank B is typically conditioned on:

- Payment (authorization to debit their account) by Party Y to Bank B, or
- Acceptance/Issuance by Party Y of a financial document (drafts, promissory notes, cheques or other similar instruments used for obtaining money) agreeing to pay Party X at a specified future date or
- Other stipulated terms and conditions

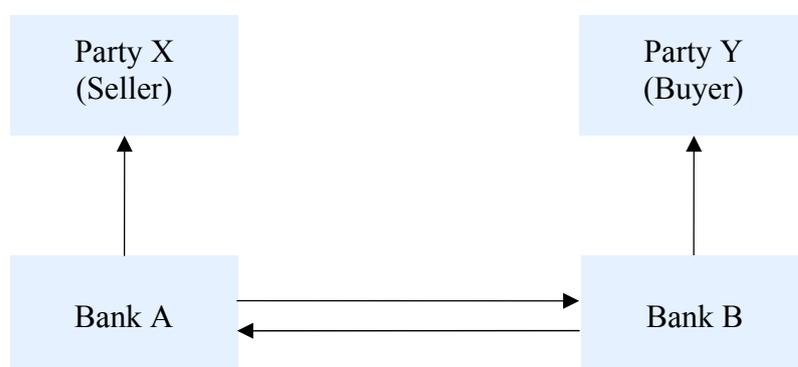
The presentation terms (collection instruction) are determined by Party X and conveyed to Bank A, who in turn, provides the collection instruction to Bank B at the time of presentation of documents for collection. Unless otherwise specifically agreed, neither bank incurs any liability to make payment.

This guidance/appendix will describe various controls which could or may be applied by FIs in the context of the collection.



A summary of the due diligence and reviewing activities (which are described in more detail later) is provided in the two flow charts which follow.

Due Diligence Overview

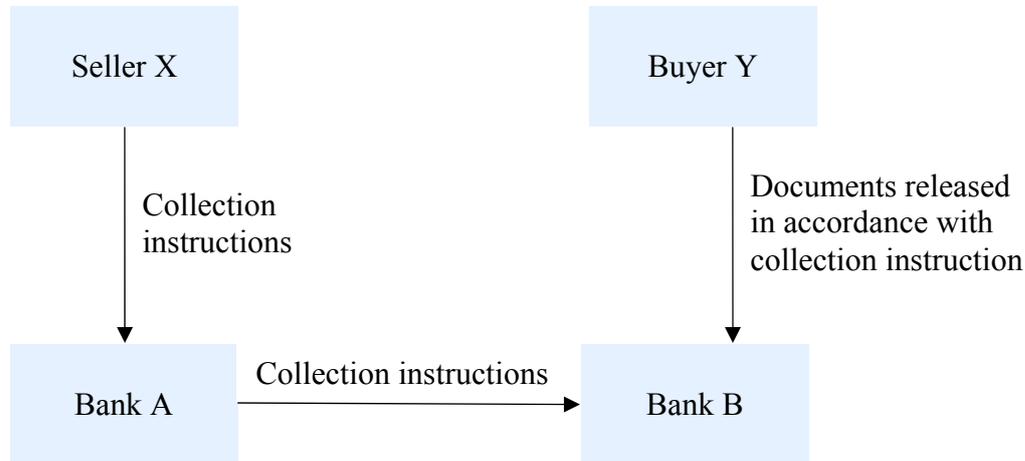


The banks will conduct due diligence which will normally follow the pattern described below

- Bank A will conduct due diligence on X

- Bank A may conduct appropriate due diligence on Bank B
- Bank B may conduct appropriate due diligence on Bank A
- Bank B will conduct due diligence on Y

Reviewing activity overview



Once the BC is initiated the banks will then review the transaction in accordance with standard banking practice at various stages through to the eventual payment being made. This reviewing activity will normally follow the pattern described below

- Bank A will review the collection instruction from X
- Bank B will review the collection instruction received from Bank A
- Bank A and Bank B will review the payment (or other) instructions received.

Controls undertaken by Bank A

Party X Due diligence

Bank A should conduct appropriate due diligence (Identification, verification screening & KYC) on Party X (who is a Customer of Bank A) prior to acceptance and execution of the original instruction. This is likely to involve a series of standardised procedures for account opening within Bank A.

As the handling of BCs involves no direct financial responsibility for Bank A and does not involve Bank A necessarily in any lending to Party X the normal due diligence for opening an account will generally apply.

Enhanced Due Diligence

An enhanced due diligence process should be automatically applied where party X falls into a higher risk category or where the nature of their trade as disclosed during the standard due diligence process suggests that enhanced due diligence would be prudent. The enhanced due diligence should be designed to understand the trade cycle and may involve establishing

- The countries where Party X trades
- The goods traded
- The type and nature of principal parties with whom Party X does business.

The nature of business and the anticipated transactions as described and disclosed in the initial due diligence stage may not necessarily suggest a higher risk category but if this becomes apparent after transactions commence this may warrant additional due diligence.

Bank B -Due Diligence

Bank A should undertake appropriate due diligence on Bank B. The due diligence may support an ongoing relationship with Bank B which will be subject to a relevant risk based review cycle. Due diligence on Bank B is not therefore required in relation to each subsequent transaction.

In other circumstances Bank B may neither have nor need to have a relationship with Bank A. Bank A will need to decide when sending the BC to Bank B whether it should undertake any checks in relation to Bank B or whether it should route the collection through another intermediate Bank with whom a relationship already exists.

See the Wolfsberg Correspondent Banking Standards for guidance with respect to the level of due diligence to be performed in relation to Bank B.

Reviewing

The level of reviewing activity may be limited to that described as standard below. .

Standard

Appropriate reviewing may be conducted by Bank A in relation to the BC instruction received from Party X which may take account of the following.

Sanctions & terrorist lists which may affect

- Any principal party as named target
- The country in which Bank B and Party Y is located
- The goods involved

Enhanced

Enhanced reviewing is likely to be applied only to transactions where there is a particular reason for closer examination or scrutiny, and which may then take account of the following

The countries which are rated as high risk for other reasons, as related to

- The countries where Bank B or Party Y are located
- Transit countries through which the goods will be shipped (only if visible on the collection instruction)

The goods described in the transaction to ensure that the nature of these goods does not appear inconsistent with what is known of Party X

Depending on the information arising from this screening process Bank A may need to

- Make further internal enquires as to the appropriate course of action
- Request more information from Party X before agreeing to proceed with the transaction
- Allow the transaction to proceed but make a record of the circumstances for review purposes
- Decline the transaction if enquiries do not provide reasonable explanations, and subject to circumstances and local legal requirements submit a suspicious activity report

Monitoring

For Bank A the monitoring opportunities arise from

- The normal procedures for monitoring Party X's account and transactional activity.
- Party Xs activity observed from business as usual trade processing more generally.

Limitations faced by Bank A

Since Bank A has no relationship with Party Y, any review of Party Y's name will likely be limited to sanctions screening. In handling the BC Bank A has no responsibility for making payment or for checking documents.

Controls undertaken by Bank B

Due diligence

Bank A Due Diligence

Bank B should undertake appropriate due diligence on Bank A. The due diligence may support an ongoing relationship with Bank A which will be subject to a relevant risk based review cycle. Due diligence on Bank A is not therefore required in relation to each subsequent transaction.

In other circumstances Bank B may neither have nor need to have a relationship with Bank A. Bank B will need to decide when receiving the BC from Bank A whether it should undertake any checks in relation to Bank A or whether it should consider requesting Bank A to route the BC through another intermediate Bank with whom a relationship already exists.

See the Wolfsberg Correspondent Banking Standards for guidance with respect to the level of due diligence to be performed in relation to Bank A.

Party Y due diligence

Bank B's normal due diligence on Party Y will apply.

Enhanced Due diligence

An enhanced due diligence process should be automatically applied where Party Y falls into a higher risk category or where the nature of their trade as disclosed during the standard due diligence process suggests that enhanced due diligence would be prudent. The enhanced due diligence should be designed to understand the trade cycle and may involve establishing

- The countries where Party Y trades
- The goods that are normally traded
- The type and nature of parties with whom Party Y does business.

The nature of business and the anticipated transactions as described and disclosed in the initial due diligence stage may not necessarily suggest a higher risk category but, if it becomes apparent after transactions commence, this may warrant additional due diligence.

Reviewing

Reviewing should take place upon receiving the BC from Bank A.

The level of reviewing may be limited to that described as standard.

Standard

Appropriate screening should be conducted by Bank B in relation to the BC when received from Bank A which may take account of the following

Sanctions & terrorist lists, which may affect

- Any principal party as a named target
- The country in which Bank A and Party X is located
- The goods involved

Enhanced

Enhanced reviewing is only likely to be applied to transactions where there is a particular reason for closer examination or scrutiny and which may then take account of the following.

The countries which are rated as high risk for other reasons, as related to

- The countries where Bank A or Party X are located
- Transit countries through which the goods will be shipped (only if visible on the collection instruction)

The goods described in the transaction to ensure that the nature and value of these appear to make sense.

Depending on the information arising from this process Bank B may need to

- Make further internal enquires as to the appropriate course of action
- Request more information from Bank A before agreeing to proceed with the transaction (after having regard to internal guidance received)
- Allow the transaction to proceed but make a record of the circumstances for monitoring purposes

Monitoring

For Bank B the monitoring opportunities arise from

- The normal procedures for monitoring the account and payment activity of Party Y.
- Patterns of activity observed from business as usual trade processing more generally

Limitations faced by Bank B

Bank B is not the originator of the transaction but is requested to act on instructions received by Bank A (although it is not obliged to do so). In accordance with established practice for handling BCs, Bank B will have limited time in which to act upon such instructions. In handling the BC Bank B's role for the due diligence on Party X is limited to reviewing of Party X's name against sanctions and terrorist lists.

Risk Indicators Pre and Post Event

In handling BCs banks do not incur independent undertakings. The terms of the BC simply set out the basis on which the seller's documents will be passed on to the buyer. These terms do not set out the information which is required to appear in the seller's documents nor the underlying transportation terms involved. A Bank's position with regard to checking

documents is therefore fundamentally different to the position with LCs. A detailed examination of documents attached to a BC is consequently unlikely to be productive due to the absence of any specified terms and conditions against which to check them.

Since the full execution of each BC transaction is a fragmented process involving a number of parties, each with varying degrees of information about the transaction, it is extremely rare for any one Bank to have the opportunity to review an overall trade financing process in complete detail given the premise of the trade business that banks deal only in documents. Furthermore it is relevant to note that

- Different Banks have varying degrees of systems capabilities which will lead to industry wide differences in their reviewing abilities
- Commercial practices and industry standards determine finite timescales in which to act.
- In determining whether transactions are suspicious due to over or under invoicing (or any other circumstances where there is misrepresentation of value) it needs to be understood that Banks are not required to check the underlying documents presented with BCs.

For Banks involved in processing BCs, the knowledge and experience of their trade staff is a line of defence against criminal abuses of these products and services but reviewing trade instructions and, where applicable, the documentation, is a highly manual process

Potentially there are a large number of risk indicators. Against this background it is important to distinguish between

- 1 Information which must be validated before transactions are allowed to proceed or complete and which may prevent such completion (e.g. a terrorist name, UN sanctioned entity).
- 2 Information which ought to be used in post event analysis as part of the investigation and suspicious activity reporting process

Appended below is a list of the some of the indicators which might become visible in the handling of the BC. We are not showing here the wider range of indicators which might apply generally across the customer / bank relationship. It is also important to note that many of the risk indicators will only become apparent after the transaction has taken place and will only be known to law enforcement or financial investigation units as part of their formal investigation processes. The majority of risk indicators fall into this category and in isolation these will have limited use.

Some Risk Indicators

WHAT	WHEN
Activity or information connected with the BC	Pre or post transaction
Goods <ul style="list-style-type: none"> • Applicable export or import controls may not be complied with 	PRE
Goods <ul style="list-style-type: none"> • Manifest anomalies value v quantity (to the extent reviewed and to the extent apparent) • Manifestly out of line with customers known business 	PRE or POST
Countries/principal parties <ul style="list-style-type: none"> • On the Sanctions/terrorist list 	PRE
Countries <ul style="list-style-type: none"> • On the Bank's high risk list • Any attempt to disguise/circumvent countries involved in the actual trade 	PRE or POST
Payment instructions <ul style="list-style-type: none"> • Illogical • Last minute changes 	PRE or POST
Repayment arrangements <ul style="list-style-type: none"> • Third parties are funding or part funding the collection 	PRE or POST
Counterparties <ul style="list-style-type: none"> • Connected drawer/drawee, where obvious 	PRE or POST
Anomalies in instructions <ul style="list-style-type: none"> • Unexplained third parties • Absence of transport documents 	PRE or POST

Summary of key controls described in this guidance on BCs

TRANSACTION STAGE	WHO/WHAT IS SCREENED	AGAINST WHAT	BY WHOM
Account opening party Party X	<ul style="list-style-type: none"> • Party X 	Appropriate due diligence	Bank A
BC instruction from Party X	<ul style="list-style-type: none"> • Party X • Party Y • Countries • Goods type 	Appropriate due diligence, sanctions and terrorist lists Sanctions and terrorist lists Sanctions and terrorist lists Local applicable restrictions	Bank A
BC instruction from Bank A to Bank B	<ul style="list-style-type: none"> • Bank A • Party X • Party Y • Countries • Goods type 	Appropriate due diligence, sanctions and terrorist lists Sanctions and terrorist lists Appropriate due diligence, sanctions and terrorist lists Sanctions and terrorist lists Applicable restrictions	Bank B
BC presented by Bank B to Party Y	<ul style="list-style-type: none"> • Party Y 	Appropriate due diligence records	Bank B
Payment by Party Y to Bank B	<ul style="list-style-type: none"> • Names on the payment instruction 	Sanctions and terrorist lists	Bank B
Payment by Bank B to Bank A	<ul style="list-style-type: none"> • Names on the payment instruction 	Sanctions and terrorist lists	Bank B
Payment by Bank A to Party X	<ul style="list-style-type: none"> • Names on the payment instruction 	Sanctions and terrorist lists	Bank A

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Appendix III

Guidance in relation to Sanctions, including Non Proliferation, Weapons of Mass Destruction and Dual Use Goods (NP WMD)

(Within this Appendix, reference to Banks rather than FIs will be used in order to achieve consistency with the preceding Appendices I and II).

Introduction

The Trade Finance Principles Paper sets out as one of its objectives the provision of some guidance on this difficult subject. The preceding Appendices I and II dealing with LCs and BCs set out the extent to which Banks already address the problems posed by sanctions, named terrorists and applicable export controls, where known, in the context of all the activities they undertake.

Sanctions exist in various forms both nationally and internationally. Some of these directly concern NPWMD.

This appendix highlights the control mechanisms considered most relevant to Banks and should be read in conjunction with the guidance on money laundering and terrorist financing (AML) risks within the principles paper and the other appendices.

The FATF Proliferation Report (June 2008) is a significant reference source. It identifies the important role of a number of stakeholders and acknowledges the difficulties which Banks face in detecting proliferation financing.

Customer Due Diligence

It is not proposed to repeat the detail here, but clearly the due diligence process in relation to customers represents an important control and is one which is expected to be enhanced where higher risk circumstances are recognised

Name Screening

The application of AML controls provides a good foundation for sanctions controls. Banks generally have in place screening systems or processes which are designed to match the name related data which they process against relevant (so called "bad guy") lists. This process can be applied to ensure that an LC or BC does not

- involve as a principal party a target name appearing on UN or applicable regional or local sanctions lists
- result in a payment to such a target

In order to achieve this Banks need to refer to relevant external sources or subscribe to information providers. Clearly the effectiveness of this control is dependent upon the accuracy, quality and usability of the source lists which contain the details of target names. A very substantial practical issue already faced by banks is the volume of false hits which can occur in their payment systems as a result of automated screening. A false hit is where a partial or unconfirmed match occurs between the Bank data and the data in the bad guy list. A partial match will occur where target names have similar or common elements with non targets. An

unconfirmed match would occur if the names match, but investigation confirms that the underlying identities are not the same.

Activity based financial sanctions

Where the target of the relevant sanctions is not specifically identified by name this makes any effective screening of a transaction by banks exceptionally difficult, whether automated or manual processes are used.

Banks should of course be aware of UN resolutions in relation to the proliferation of nuclear weapons, WMD, Dual Use Goods and of relevant local legislation which translates these into national laws or regulations.

Guidance on this is also issued by FATF and in regions where an export licensing control regime is in place by the relevant authorities. Other programmes address the more conventional threat from missiles, chemical weapons and related activity.

Available sources include the following:

- The Wassenaar Arrangement which has been established in order to contribute to regional and international security and stability, by promoting transparency and greater responsibility in transfers of conventional arms and dual-use goods and technologies

<http://www.wassenaar.org/controllists/index.html>

- UN Security Council Resolution 1737 (2006)
http://www.un.org/Docs/sc/unsc_resolutions06.htm

and the supporting documents referred to therein.

<http://www.iaea.org/DataCenter/index.html>

- FATF Guidance regarding the implementation of financial provisions of UNSCRs to counter the proliferation of WMDs (June 2007)

FATF Guidance regarding the implementation of activity-based financial provisions of UNSCR 1737 (October 2007)

FATF report on Proliferation Financing (June 2008)

<http://www.fatf-gafi.org/>

Banks should to the extent possible use the available information in relation to parties giving them instructions, goods and the countries involved. It should however be recognised that any practical application of this information may be severely limited.

Limitations

The challenge, particularly in relation to activity based financial sanctions is considerable. The following points are particularly relevant.

- Payments made through banks in support of open account trade (which accounts for some 80% of all international trade) can only be screened by reference to the disclosed name data.
- The successful facilitation of international trade through LCs and BCs relies on the adherence to recognised international banking standards applicable to these products.

Following the initial customer due diligence and once an LC has been issued or a BC despatched the remaining activities conducted by the participating banks need to be completed within certain timescales.

- Information or details within the documentation presented to Banks may be insufficient to disclose the exact nature of the transaction.
- When handling BC s in particular a detailed examination of documents accompanying the BC is not possible. This is fundamentally different from the position under LCs (Refer to appendix (ii))
- Interpretation of “dual use” requires a degree of technical knowledge that L/C document checkers cannot be expected to possess. In addition, goods descriptions may appear in the documents using a wording which does not allow the identification of such goods as “dual use”.
- Regardless of the details in the information sources, without the necessary technical qualifications and knowledge across a wide range of products and goods the ability of a bank to understand the varying applications of dual use goods will be virtually impossible. It would be impracticable for Banks to employ departments of specialists for this purpose as in doing so they would need to replicate comprehensive scientific research facilities.
- Countries known to be involved directly may be named in sanctions but countries which are technology producers or are “diversion risk” countries used for the transit or re export of goods may well not appear on any warning lists.

Conclusion

As explained in section 6 of the Principles Paper, banks are only one of the relevant stakeholders. Whilst Banks are a primary conduit for the movement of funds substantial participation from other key stakeholders is required in order to provide an effective deterrence effort and to aid the detection/s discovery of the relevant targets in this area.

Wolfsberg Trade Finance Principles Paper

Appendix IV

Glossary of selected terms used generally in Trade Finance **and in this Wolfsberg Trade Finance Principles Paper and** **Appendices**

Acceptance: The act of giving a written undertaking on the face of a usance bill of exchange to pay a stated sum on the maturity date indicated on the bill of exchange. If an acceptance is created by a Bank, it is known as a Bankers Acceptance. If it is accepted by a corporate entity it is known as a trade acceptance. In BCs, documents of title to shipped goods are typically exchanged for a usance bill of exchange that has been accepted by the drawee (trade acceptance) when documents are sent using Documents against Acceptance (D/A) terms.

Advising: Act of conveying the terms and conditions of an LC to the beneficiary. The advising bank is the correspondent of the issuing bank, usually located in the beneficiary country. Advising also involves authentication i.e. advising bank should take reasonable care to check the apparent authenticity of the LC and in the event it cannot determine the apparent authenticity of the LC it must so notify the issuing bank and if it nonetheless elects to advise the LC to the beneficiary, it must also inform the beneficiary.

Amendment: Alteration to the terms of an LC; amendments must stem from the applicant, be issued by the issuing bank and advised to the beneficiary. The beneficiary has the right to refuse an amendment if the LC is irrevocable.

Applicant: One who applies to his bank to issue an LC. In the majority of LCs issued, the applicant is an importer of goods.

Back-to-Back Credit: An LC issued against the security of another LC (master credit) on the understanding that reimbursement will stem from documents eventually presented under the first credit (master credit) issued. It follows therefore that each side of a Back to Back transaction covers the shipment of the same goods although price differentials in the goods will exist since this is usually where the beneficiary of the Master credit makes a profit.

Beneficiary: A payee or recipient, usually of money. A party in whose favour an LCs established. In an LC the beneficiary is usually the exporter of the goods covered by LC.

Bill for Collection (BC): Documents (including a Bill of Exchange or draft) submitted through a bank for collection of payment from the drawee, also known as Documentary Collection.

Bill of Exchange: A written unconditional order to pay, addressed by one party (the drawee) to another, signed by the party giving it (the drawer), requiring the drawee to pay the drawer a specified sum of money, on demand or at fixed or determinable future time.

Clean: Used to describe a payment which is handled without the presence of or reference to any of the underlying commercial documents.

Collecting Bank: In BCs it is the Bank in the drawee country that is instructed to collect payment from the drawee.

Collection Order: Form submitted, with documents, to the remitting/negotiating bank by an exporter with his instructions. Also known as Collection Instruction

Confirming: Act of a bank other than the issuing bank assuming the liability for payment, acceptance or negotiation of correctly presented documents under an LC.

Contingent Liability: A liability that arises only under specified conditions, e.g. when a bank opens an LC it incurs an obligation to make a future payment on condition that a conforming demand for payment is made under such LC by the beneficiary.

Credit: Where a bank lends money or assumes a contingent liability. (i.e. credit facilities or the granting of credit approval).

Discounting: Act of purchasing or prepaying an accepted usance bill of exchange or documents presented under an LC.

Discrepancy: Any deviation from the terms and conditions of an LC, or from international standard banking practice or any applicable ICC rules existing in the documents presented thereunder, or any inconsistency between the documents themselves.

Documentary Collection: See Bill for Collection (BC)

Documentary Credit (DC): An undertaking by a bank to make payment, often abbreviated as "credit". More precisely, it is a written undertaking by a bank (issuing bank) given to the seller (beneficiary) at the request of the buyer (applicant) to pay a stated sum of money against presentation of documents complying with the terms of the credit within a set time limit. The term Documentary Credit includes both Commercial and Standby letters of credit.

Documents Against Acceptance (D/A): Instruction used in BCAs Documentary Collections for commercial documents to be released to the drawee in exchange for the drawee's acceptance of the Bill of Exchange.

Documents Against Payment (D/P): Instruction used in BCs for documents to be released to the drawee in exchange for payment.

Draft or Bill of Exchange: A financial document evidencing a demand for payment of a stated sum of money that is issued by an exporter (the drawer) and submitted to his bank for collection from the drawee, Under an LC this document is usually submitted along with shipping documents.

Drawee: The party from whom payment is expected. In BCs the drawee is usually the buyer, in LCs; the drawee is typically the issuing or confirming bank.

Drawer: The party who is demanding payment; in Documentary Collections and Commercial Letters of Credit, the drawer is typically the seller of the goods.

Due Date: Maturity date for payment.

International Chamber of Commerce (ICC): The international body which promotes and facilitates world trade, and which codifies world trade practices in various publications.

Issuing Bank: The bank that opens an LC at the request of its customer, the applicant.

Letter of Credit (LC): Common parlance term See Documentary Credit

Negotiation: The purchase by a nominated bank of drafts (drawn on a bank other than the nominated bank) or documents under a complying presentation under an LC by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

Opener: See Applicant.

Opening Bank: See Issuing Bank.

Paying Bank: The bank that makes payment to the beneficiary of a payment LC after presentation to it of documents stipulated in the LC.

Presentation: In LCs, it is either the delivery of documents under an LC to the issuing bank or to the nominated bank or the documents so presented. In BCs, it is the act of a collecting bank, performing in the capacity of presenting bank that contacts the drawee for payment or acceptance, in accordance with the collection instruction.

Presenting Bank: Under LCs, it is the bank that presents drafts and/or documents for payment. In BCs, it is the collecting bank that makes presentation to the drawee...

Principal: A term used in BCs that means the party entrusting the handling of a collection to a bank.

Reimbursing Bank: The bank nominated by the LC issuing bank that will pay the value of the LC to the negotiating/paying bank.

Remitting Bank: A term used in BCs that means the bank to which the principal has entrusted the handling of a collection.

Schedule: The remitting/negotiating/presenting bank's letter covering bills of exchange and/or documents sent to the collecting/issuing bank, which lists the documents attached and gives collection and/or payment instructions. In BCs this is also known as the Collection Instruction.

Sight: A term used to mean immediate payment. A bill of exchange payable at sight is payable on presentation to the drawee, i.e. on demand.

Transferable Credit: Permits the beneficiary to transfer all or some of the rights and obligations under the LC to a second beneficiary or beneficiaries.

UCP 600: ICC publication, Uniform Customs and Practice for Documentary Credits (2007 revision) replaced the previous UCP 500 as from 1 July 2007.

URC 522: ICC publication, Uniform Rules for Collections (1995 revision).

Usance Bill: A Bill of Exchange (draft) which allows the drawee a term or period of time before payment (this period is also called usance). The term is usually stated in days (e.g. 30 days) and starts either from the date of the bill (e.g. 30 days date) or from the date of shipment, or from sight by the drawee (e.g. 30 days sight) which in practice means from the date of acceptance.

Waive: To relinquish a right: used in BCs with charges and/or interest to be collected from the drawee: used in relation to LCs where the applicant agrees to pay for documents presented after waiving the presence of discrepancies in the documents.