Shift to Open Account Trade Highlights Evolving Risks in the Maritime Sector

About This Policy Alert

This alert was created in collaboration with Windward, the global leader in maritime insights. Windward's AI-powered solution fuses maritime expertise with best-in-class data, to enable real-time, predictive intelligence-driven decisions, providing a complete view of risk across the maritime ecosystem and its broader impact on safety, security, finance, and business.

Summary

In recent years, importers, exporters, and their financial institutions have shifted away from traditional, document-based trade finance instruments and toward non-documentary, "open account" settlement through clean wire transfers. Since 2014, traditional trade transactions have declined by 58 percent as a proportion of overall message traffic, according to data from the Society for Worldwide Interbank Financial Telecommunication ("SWIFT")—despite a continued expansion of global trade in goods and services over the same period.[1]

The rapid growth of clean wire transfers significantly increases the sanctions risks that financial institutions face in the maritime sector, which has been a recent focus of U.S. and European authorities.[2] Without access to the information included in traditional trade finance documents—and absent additional risk mitigation steps, as described below—banks may be insufficiently positioned to identify illicit shipments and vessels, flag trade-based money laundering schemes, and assess key sanctions and proliferation financing risks.

Lack of Payment Transparency in Open Account Trade

Open account trade today accounts for 80 percent of international trade transactions but provides banks with only a fraction of the risk-relevant information they would receive through document-based trade finance arrangements.[3]

- When processing traditional trade transactions, such as a shipment financed with a documentary letter of credit, banks will typically have access to detailed information regarding the type and quantity of the underlying goods involved in shipment, the identity and location of the buyer and seller, the vessel name and shipping company, and applicable shipping routes and destinations.
- In open account trade, goods are shipped and delivered before payment is due, and shipping documents are sent directly from the seller to the buyer, rather than through a bank. As a result, even banks originating open account trade transactions on behalf of their customers may lack critical information regarding the goods, shipping vessels, or transport routes associated with a given transaction. Such informational gaps are likely to be even more pronounced for intermediary banks that typically receive only limited originator and beneficiary information in a wire payment message and are reliant on originating banks for the inclusion of this required minimum information.[4]
- Moreover, although originator and beneficiary banks will have access to the customer due diligence files of their direct customers—allowing them to review information regarding their beneficial owners, business activities, and past transactions through the bank—intermediary banks will lack even this minimum baseline of information for understanding the parties to the transaction and the nature of their activities.
- SWIFT's messaging formats include certain optional general information fields in which ordering institutions may include additional information regarding the nature and purpose of the transaction, the identity of vessels or other related parties, and associated transport routes. However, the inclusion of such information is not currently mandated under international standards for cross-border wire transfers.[5] Financial institutions processing open account trade transactions therefore may not understand the type of goods involved in the underlying shipment, who is transporting the goods, including whether they are sanctioned or high-risk entities, or whether the shipment is stopping in a sanctioned jurisdiction.

The shift toward open account trade has coincided with a continued expansion of global trade in goods and services, which has more than tripled in real-dollar terms over the past two decades.[6]

Sanctions and Proliferation Financing Risks in Cross-Border Trade

Cross-border trade finance is among the highest-risk activities in which banks routinely engage, since malign actors—including Iran, North Korea, and Syria—constantly seek novel ways to exploit global supply chains for their benefit and hide illicit activities in trade finance channels.[7] The illicit financing risks inherent in cross-border trade are heightened further when conducted on open account terms rather than through a documentary finance instrument, as clean wire payments typically lack critical information about the nature and purpose of the underlying activity and the identity and role of related parties to the transaction.

Transactions involving shipment services present an even greater challenge to compliance teams. Entities and vessels associated with sanctions evasion, arms trafficking, smuggling of narcotics, and trafficking, among other illicit activities, may expose financial institutions to myriad risks.

Many authorities, including the U.S. Office of Foreign Assets Control (“OFAC”), alongside national anti-money laundering (“AML”) regulators, increasingly expect financial institutions to implement sophisticated controls when it comes to shipping including screening and monitoring for potential sanctions violations, trade-based money laundering, and other high-risk transactions.

The Financial Action Task Force (“FATF”) has identified 31 “red flags” for sanctions evasion and proliferation financing activity to assist the public and private sectors in identifying customers, transactions, and other activities involved in these illicit activities.[8]

- Information relating to the vast majority of red flags applicable to the documentary trade finance context is often readily available in documents provided to applicant or advising banks during the letter of credit application process.
- By contrast, information relating to only approximately one out of every four red flags applicable to the open account trade context is often readily available in a payment message received by a bank in a trade transaction settled by clean wire payment (typically, a SWIFT MT 103 for the customer transfer, often together with an MT 202 COV for any accompanying transfers between financial institutions).[9]

Considerations for Financial Institutions

To reduce their sanctions exposure, banks should apply letter of credit-like due diligence to certain high-risk wire transfers so as to identify all parties and underlying economic activity involved in such high-risk transactions.

- Intermediary banks should screen any additional information provided in optional payment message information fields—including the identities of vessels or any other related parties, information regarding the type of underlying goods, and any transshipment points—and should consider including in contractual agreements with their foreign respondent banks a requirement to use such fields to flag known open account trade payments and provide minimum information related to associated vessels or other shipping risks.
- Banks should conduct full due diligence on transactions flagged by existing anti-money laundering scenarios or sanctions filters, seeking information from public sources and the originating and beneficiary banks to gain a full understanding of the transaction and the parties involved.
- Many banks have tools to screen companies and vessels identified on shipping documents for red flags, however, there are significant gaps in their ability to keep up with new data manipulation techniques that have emerged in an apparent effort to facilitate sanction or illegal trade. To proactively mitigate risk and meet regulatory requirements, there are new AI-driven behavioral analysis solutions that enable banks to actively identify potential sanction evaders before government authorities designate them. Using these new technologies allows them to protect their organizations while keeping business on track.
- Banks should also design new scenarios based on FATF's sanctions evasion and proliferation financing red flags, insofar as these are readily observable in clean wire payments.

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Endnotes

[1] Based on an analysis of year-to-date average daily message volumes (October 2014 through October 2020) from the SWIFT FIN Document Centre, available at: https://www.swift.com/about-us/swift-fin-traffic-figures/swift-fin-traffic-document-centre, and World Bank national accounts data for the exports of goods and services in current U.S. dollars, available at https://data.worldbank.org/indicator/NE.EXP.GNFS.CD.

[2] See generally Department of the Treasury, Department of State, and United States Coast Guard, "Sanctions Advisory for the Maritime Industry, Energy and Metals Sectors, and Related Communities," available at https://home.treasury.gov/system/files/126/05142020_global_advisory_v1.pdf and HM Treasury, Office of Financial Sanctions Implementation, "Maritime Guidance: Financial Sanctions Guidance for Entities and Individuals Operating within the Maritime Shipping Sector," available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/903901/OFSI_-_Maritime_guidance__July_2020_.pdf.

3 The Wolfsberg Group, International Chamber of Commerce, and Bankers Association for Finance and Trade, Trade Finance Principles (2019), at 21, available at https://www.wolfsberg-principles.com/sites/default/files/wb/Trade%20Finance%20Principles%202019.pdf.

[4] See Financial Action Task Force ("FATF"), The FATF Recommendations: International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation (2012; updated October 2020), Interpretive Note to Recommendation 16, at 79, available at http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf. Recommendation 16 specifies that all cross-border qualifying wire transfers must contain: (a) the name of the originator; (b) the originator account number; (c) the originator's address, national identity number, customer identification number, or date and place of birth; (d) the name of the beneficiary; and (e) the beneficiary account number. Inclusion of the beneficiary's address is an industry standard but is not required under Recommendation 16. Intermediary banks are expected under global standards to "take reasonable measures to identify cross-border wire transfers that lack required originator information or required beneficiary information" (Interpretive Note to Recommendation 16, at 80). Global standards do not require originating banks to include specific information related to the nature or purpose of the transaction or the identity of vessels or other related parties.

[5] See FATF, The FATF Recommendations, Recommendation 16, at 17-18, and Interpretive Note to Recommendation 16, at 78-81.

[6] The World Bank, "Exports of Goods and Services (Current US$)" (national accounts data from 2000 through 2019), available at: https://data.worldbank.org/indicator/NE.EXP.GNFS.CD.

[7] See Department of the Treasury, Department of State, and United States Coast Guard, "Sanctions Advisory for the Maritime Industry, Energy and Metals Sectors, and Related Communities," at 2, available at https://home.treasury.gov/system/files/126/05142020_global_advisory_v1.pdf.

[8] FATF, FATF Guidance on Counter Proliferation Financing (February 2018), Annex A, at 32-34, available at: http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Countering-Proliferation-Financing.pdf.

[9] For a complete analysis, see "Trade Finance," Table 2: Proliferation Red Flags for Trade Finance Transactions, available on the Dedicated Online Financial Integrity Network ("DOLFIN") at https://dolfinapp.finintegrity.com/resource/4-2-trade-finance/.