The Wolfsberg Group, ICC and BAFT Trade Finance Principles

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Foreword

The Wolfsberg Group Trade Finance Principles paper and appendices were last updated in 2011. Since then regulatory expectations and a more stringent application of existing regulations have made it necessary to review the paper, identify where expectations have changed and, therefore, where the basic principles or their application need to be readdressed.

Since the last revision, the Wolfsberg Group has had an increasingly close dialogue with the ICC to see how the principles could be better disseminated to the ICC membership with a view to raising and standardising the practice level of Financial Crime Compliance (FCC) within the Trade Finance industry.

To date, the only other publicly available guidance, which was specific to the United States, was the January 2008 BAFT IFSA "*Guidelines for Bank Secrecy Act/Anti-Money Laundering for Trade Services*"[1] and a subsequent March 2015 BAFT global update entitled "*Guidance for Identifying Potentially Suspicious Activity in Letters of Credit and Documentary Collections.*" [2]

In discussion with many practitioners at ICC Banking Commission meetings and other industry events, it became clear that many banks saw the Wolfsberg Principles paper as being for "large global banks" and not for "our smaller, local banks." There was also the view that if the ICC issued a guidance paper or official publication, then many more banks would see it as important to follow that guidance.

This led to the formation of the joint ICC-Wolfsberg Group Trade Finance Principles Drafting Group in April 2014, with a remit to redraft and update the Wolfsberg Trade Finance Principles paper in the style of ICC guidance, with members drawn from Wolfsberg Group banks, ICC members globally, as well as BAFT so as to broaden the global perspective as part of the drafting group.

It is important to note that the core principles have not changed, nor have the responsibilities of the banks involved in trade transactions to have a good knowledge of their customer or instructing party, the business that they conduct and with whom and where they are situated. Neither has the requirement for banks to follow strictly the regulations aimed at detecting and preventing Money Laundering, Financing of Terrorists or Terrorist Organisations, committing or assisting in Bribery and Corruption, evading tax liabilities, the proliferation of weapons of mass destruction and other financial crimes, or the evading or breaking of sanctions imposed on countries or individuals by competent authorities changed.

The core principles paper has been expanded to give more detail around what is meant by various risk mitigation activities, describes the challenges and limitations faced and also recommends actions that law enforcement, customs and other government agencies and policy makers still need to address to help the financial services industry meet its obligations under Financial Crimes Compliance frameworks.

In order to strengthen the description of the control and escalation framework that banks need to have in place in order to meet the core principles paper's guidance, the former appendices V, VI and VII on Control, Escalation and the Glossary, have been incorporated as sections 2, 3 and 4 of the new Core paper, so that readers do not need to move between appendix and the Core paper to understand the guidance given in the product specific appendices.

It is strongly recommended that practitioners also refer to the other Wolfsberg Group papers in respect of Customer Due Diligence (CDD), Correspondent Banking, the use of SWIFT RMAs, and the Risk Based Approach (RBA) all of which reflect the requirements of regulators and the "International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation," known as the FATF 40 Recommendations. These principles apply to all banks regardless of size and do not require a bank to have significant electronic systems to be in place to apply them. These principles are the basis of what was always considered to be "Good Banking Practice." Readers should also acquaint themselves with the BAFT Guidance referenced above.

[1] BAFT (2008), https://baft.org/policy/document-library
[2] BAFT (2015), https://baft.org/policy/document-library

This paper replaces the 2011 Wolfsberg Group Trade Finance Principles paper.

The former Chair of the Drafting Group, Neil Chantry, and the current Chair, Willem Toren, would like to express their gratitude to the members of the group for their diligence and endeavour in bringing this rewrite to fulfilment and to the support given by our teams and the ICC Secretariat staff.

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Trade Finance Principles

Summary and Highlights[3]

The Trade Finance Principles outlines the standards for the control of financial crime risks (FCRs) associated with Trade Finance activities. In this paper, the term "financial crime" refers to money laundering (all crimes including but not limited to, fraud, tax evasion, human trafficking), bribery and corruption, terrorist financing, the financing of proliferation of weapons of mass destruction and other related threats to the integrity of the international financial system.[4]

The Trade Finance Principles outlines the role of Financial Institutions ("FIs") in the management of processes to:

a. Address the risks of financial crime associated with Trade Finance activities.
b. Aid compliance with national and regional sanctions and embargoes and with the Non-Proliferation of Weapons of Mass Destruction ("NPWMD") requirements of the United Nations ("UN").

It is important to understand that the **Core, Control, Escalation and Glossary** sections of the core principles paper are to be read as a whole with the individual product and services covered in the Appendices.

– Core

1. Introduction

1.1 Trade Finance can be described as the provision of finance and services by FIs for the movement of goods and services between two points, either within a country or cross border. Both FIs and Trade Bodies (such as the International Chamber of Commerce and BAFT), as well as Governments are critical in promoting international commerce and free trade. FIs and Trade Bodies support the timely and efficient movement of goods, documents and payments.

1.2 The Trade Finance activities covered in this paper comprise a mix of money transaction conduits, default undertakings, performance undertakings and the provision of specific trade-related credit facilities.

1.3 There is a perception that Trade Finance is a "higher risk" area of business from a financial crime perspective, therefore, all FIs involved in Trade Finance should have risk policies and controls which are appropriate for their business. FIs should have an end-to-end FCR management programme, which can be applied to Trade Finance and the specific products and transactions outlined in this paper.

1.4 Trade Based Money Laundering ("TBML") has become a widely used term. It covers a broad spectrum of financial and other services, including those financial services referred to as Trade Finance, but also transactional activities across current and deposit accounts and payments for example, which are not in the purview of Trade Finance operations of FIs. The detection of unusual and potentially suspicious activities across transactional activities, should take place via whatever transaction monitoring systems and processes an FI has in place, be it manual or automated. For the purposes of this paper, the scope of TBML is restricted to the Trade Finance activity represented by the documents contained in the transactions and supported by the management of the FCRs related to the specific activities laid out in this paper. This guidance is based

[3] In Sections 1 and 2, Banks and FIs are used interchangeably
[4] The terms financial crime risk, money laundering or AML may be used interchangeably throughout the paper

upon the requirements of the FATF 40 recommendations and the best practices outlined in the UK FCA's Thematic Review TR13/3 of 2013.

1.5 The majority of world trade is carried out under "Open Account" terms, whereby the buyer and seller agree to the terms of the contract and goods are delivered to the buyer followed by a clean or netting payment through the banking system. Under such Open Account terms, unless the FI is providing credit facilities, the FI's involvement will be limited to the clean payment and it will not generally be aware of the underlying reason for the payment. As the FI has no visibility of the transaction, it is not able to carry out anything other than the standard anti-money laundering (AML) and sanctions screening on the clean or netting payment. If the FI is providing credit facilities in relation to the trade transaction there may be more opportunity to understand the underlying trade process and financial movements. Further reference to Open Account can be found in ***Appendix IV: Open Account***.

1.6 This paper will address (through the appendices):

a. The mechanisms used for the finance of the movement of goods or services across international boundaries.
b. Standard Trade Finance products:
- Documentary Credits ("DCs", sometimes referred to as Letters of Credit) and Documentary Bills for Collections ("BCs"). Although DCs and BCs can also be used domestically, this remains prevalent in non OECD countries. These standard products have trade related documents (invoices, transport documents) that are sent through FIs and may be 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 ("Rules").[5] These Rules, and the standard international banking practice they have created, affect the ways that FIs are able to apply FCR requirements. The Rules have been reflected in the decisions of courts in many jurisdictions and they impose court recognised timeframes and behaviour on FIs and trading parties, related to ensuring how the trade transaction is to be conducted and completed.
- Demand Guarantees (Financial and Performance) and Standby Letters of Credit ("SBLCs") in relation to Trade Finance.
- Open Account Trade.

1.7 The paper will not address:

a. Other products and or services associated with Trade Finance, such as vendor financing or specialised structured loan-based Trade Finance.
b. Other risks that may be present in Trade Finance.

1.8 For the purpose of this paper FI relationships are defined as follows:

a. Customer Relationship ("Correspondent Bank"): The Wolfsberg Group definition of Correspondent Banking[6] is "the provision of a current or other liability account, and related services, to another financial institution, including affiliates, used for the execution of third party payments and Trade Finance, as well as its own cash clearing, liquidity management and short-term borrowing or investment needs in a particular currency. A Correspondent Bank is effectively acting as its Correspondent's agent

[5] The relevant ICC Rules are for DCs "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"
[6] See the Wolfsberg Correspondent Banking Principles (2014), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Correspondent-Banking-Principles-2014.pdf

or conduit, executing and/or processing payments or other transactions for the Correspondent's customers. These customers may be individuals, legal entities or even other financial institutions. A correspondent relationship is characterised by its on-going, repetitive nature and does not generally exist in the context of one-off transactions." Payments can be made by the Respondent Bank via an account held with the Correspondent Bank, on the instructions of the Respondent Bank's customers. This type of activity poses a potential risk from a FCR perspective, as there is reliance on the Respondent Bank initiating payment to have policies and procedures that articulate appropriate levels of due diligence relating to payment initiators.

b. Non-Customer Relationship: A Non-Customer Bank is a FI that does not have a payment account relationship, and therefore cannot make third party clean payments through the other Non-Customer Bank. A Non-Customer Bank, for the purposes of this paper, can only transact documentary credits (confirmation, negotiation and discount), collections and demand guarantees, or SBLCs. The relationship allows only for a SWIFT RMA[7] plus (I.e. a Relationship Management Account) capability, whereby the FIs agree on the message types that can be exchanged relating to a subset of the MT400 message series for documentary collections and the MT700 series for documentary credits, SBLCs and demand guarantees. Thus, even though value can be exchanged via the exchange of trade documents, the FCRs are not always apparent because of the lack of the full view of the payment process. Payment is made via a mutual Correspondent or Central Bank clearing system. The underlying documents provide evidence of the transaction, some of which may be verified by reputable third parties, e.g. sea transport can be verified through the use of a well-known third party vessel and voyage history database service, or checking container numbers or voyage details through the International Maritime Bureau, a part of the ICC, in accordance with a FI's RBA.

1.9 Product Variations

There are a number of variations of the core products that are not covered in this paper and appendices. These variations put them outside the internationally accepted ICC Rules and therefore any controls that have been developed from the core products to manage the FCR, may not be in place or available as standardised control processes in the industry. It is up to individual FIs to consider the FCR inherent in these product variations and to apply suitable controls based on their RBA.

1.10 Additional appendices may be developed to reflect the growth of trade and the numerous techniques that have been and may be introduced as part of the Trade Finance market.

2. Parties in Trade Transactions

2.1 A Trade Transaction involves multiple parties. As a general rule, at least one party to the transaction should be identified as a customer and subject to appropriate due diligence procedures. FIs may apply a different level of due diligence depending on the nature of their role in the transaction, according to their RBA. That customer may be, but is not limited to, a corporation, Correspondent Bank or an individual.

2.2 Being active in international trade finance not only requires the FI to obtain a thorough understanding of their customers' business model at on-boarding (including their principal counterparties, the countries where these counterparties are located, the goods or services that are exchanged, as well as the expected annual

[7] See the Wolfsberg Guidance on SWIFT Relationship Management Application (RMA) Due Diligence (2016), http://www.wolfsberg-principles.com/pdf/home/SWIFT-RMA-Due-Diligence.pdf

transaction volumes and flows), it is becoming more and more apparent that regulators expect that this knowledge, obtained from customers, is reviewed (where appropriate) in conjunction with information provided during the actual trade transactions that the customer undertakes with the FI. This may lead to a greater emphasis on an active exchange of information between CDD information and transaction information.

2.3 International Standard Banking Practice recognises that FIs deal with documents and not with transport, delivery, goods, services, or performance to which the documents may relate. FIs 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 an FI can bring to the identification of unusual activity involving a Trade Finance transaction.

2.4 Relevant stakeholders at both a national and international level (which may include national bodies such as Governments, Law Enforcement Agencies, Financial Intelligence Units, Regulators, FATF, Export Credit Agencies, Customs and Excise, Tax Authorities, Port Authorities and businesses such as Shipping Agents and Carriers) should continue to recognise the need for on-going participation and co-operation in ensuring financial crime is not facilitated through Trade Finance activities.

3. Financial Crime Risks

3.1 Below are the elements of FCRs related to Trade Finance transactions that FIs should be aware of:

a. Risks

- It is recognised that international trade and the processes and systems that support it, are vulnerable to abuse for the purposes of financial crime. In recent years, there has been an increasing focus on these risks for a variety of reasons, including the continued growth in world trade. Furthermore, 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 may have become more attractive to criminals.

- This paper does not cover Trade Based Money Laundering as defined in the FATF report on TBML, which covers multiple areas outside of the scope of Trade Finance. The FATF Report on Trade Based Money Laundering[8] highlights that problems are 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 manipulated as a means of financing trade in order to disguise the true underlying (and potentially illegal) activity. The report also highlights the importance on the roles of all stakeholders, not just FIs, in combating money laundering.

- 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 such arrangements is obtaining a benefit in excess of what would be expected from an arm's length transaction. The collusion may 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:

[8] FATF (2008), http://www.fatf-gafi.org/documents/documents/bestpracticesontradebasedmoneylaundering.html

Method	Description
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 as 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 and or 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.

- Determining whether cases of over-invoicing or under-invoicing exist (or any other circumstances where there is misrepresentation of value) cannot easily be identified based on the trade documents alone. Furthermore, it is not feasible to make such determinations on the basis of external data sources; most products are not traded in public markets and therefore there are no publicly available market prices. Even in transactions involving regularly traded commodities, which are 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 or the specific quality of the goods involved. However, there may be situations where unit pricing appears manifestly unusual, which may prompt appropriate enquiries to be made based on the FI's RBA.

b. Risk Assessments

- FIs should determine their own compliance requirements for Trade Finance using a RBA. The RBA relates to the steps taken for individual customers or transactions, based on that FI's analysis of the risks in relation to the parties involved, the type of transaction, monetary value of the transaction and other factors that may either increase or reduce the risk of financial crime in any given transaction. FIs should review these guidelines and incorporate, as appropriate, all or part of them into their internal processes.

- The Wolfsberg Group has issued general guidance on a RBA[9] in relation to Trade Finance.

- When developing their RBA, FIs should take into consideration country factors such as the Corruption Perception Index, the FATF Deficient Countries list, sovereign and credit risk, country national risk assessment and the overall FCR environment. FIs should also take into consideration the type of relationship, such as a Customer relationship or a Non-Customer relationship.

- As with their other lines of business, services, and products, FIs should apply a RBA to the assessment and management of risk in relation to Trade Finance.

[9] Wolfsberg Statement - Guidance on a Risk Based Approach for Managing Money Laundering Risks (2006), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg_RBA_Guidance_(2006).pdf

- The assessment of risk and application of appropriate FCR controls depends on the role of an FI in a trade transaction. As Trade Finance transactions may involve a number of FIs there will be an interdependence 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 advocated in the Wolfsberg Correspondent Banking Principles[10] are relevant.

c. Application of Controls

- FIs review trade transactions on an individual basis, for fraud, sanctions and for unusual and potentially suspicious activities. Generally transactions are examined for the application of relevant ICC rules and for whether the documented conditions conform to international standard banking practice and what is known of the customer.

- The complex, paper based nature of 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 and individuals), the overall process of reviewing trade documents by its nature cannot be successfully automated. A combination of automated and manual controls will be relevant in the context of AML and counter-terrorist financing (CTF) efforts.

- Individual FIs will configure their own transaction monitoring programmes accordingly, however it is difficult for one FI to manage all the FCRs in the end-to-end process given the multiplicity of parties involved (from producer or exporter to the final buyer).

- The most effective method of identifying terrorist involvement in Trade Finance transactions is for competent authorities to identify individuals and organisations connected to terrorist activities and provide such information to FIs in a timely manner. Accordingly, Trade Finance controls, consisting of screening relevant transaction information against lists of known or suspected terrorists (designated parties) issued by competent authorities having jurisdiction over the relevant FI, are relevant in the context of CTF 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 Control Mechanisms section and in the appendices. ***Appendix I: Documentary Credits***, ***Appendix II: Bills for Collection***, ***Appendix III: Guarantees and Standby Letters of Credit, Appendix IV: Open Account Trade***.

3.2 Documenting Decisions: As part of the application of controls in 3.1 c) above, FIs are expected to have procedures and processes in place which allow staff to record the basis of their decision in respect of any risk indicators or assessments of transaction risks that arise at any stage of a transaction. FIs are also expected to ensure that those comments are kept as part of the transaction audit trail for review as part of the control effectiveness and quality assurance processes, as well as evidence for audit and regulatory purposes.

[10] Wolfsberg Anti-Money Laundering Principles for Correspondent Banking (2014), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Correspondent-Banking-Principles-2014.pdf

4. National and Regional Sanctions, Embargoes and NPWMD

4.1 Below are the elements of national and regional sanctions, embargoes and the Non-Proliferation of Weapons of Mass Destruction ("NPWMD") that FIs should be aware of.

For the purposes of this paper, the following definitions will be used:

- Sanctions: Economic and, or trade based measures taken by a government or international body to promote foreign policy or national security goals against certain jurisdictions or targeted individuals or entities. Sanctions can be sectoral, unilateral (imposed by only one country or body on one other country or body), or multilateral (imposed by one or more countries or bodies on a number of different countries or bodies).

- Embargoes: An embargo restricts commerce of exchange with a specified country. An embargo is usually created as a result of unfavourable political or economic circumstances between nations. The restriction looks to isolate the country and create difficulties for its governing body, forcing it to act on the underlying issue.

- NPWMD: This term refers to the prevention of proliferation of nuclear, chemical and biological weapons, as well as their means of delivery.

- Anti-Boycott measures: This term refers to measures undertaken by FIs to ensure that Trade Finance transactions do not become subject to non-sanctioned embargoes designed to isolate or create economic disadvantages for certain countries where there is countervailing legislation that they are subject to.

a. Sanctions
   i. There are a variety of United Nations ("UN") and other multilateral and unilateral sanctions and embargoes in place.
   ii. There have 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 and prevention of Terrorist Financing.
   iii. These are augmented by:
      - Financial sanctions and embargoes that target specific individuals and entities
      - Trade based sanctions: Embargoes on the provision of certain goods, services, or expertise to certain countries.
   iv. Sanctions that require the embargo of certain goods and services are particularly relevant to the provision and facilitation of Trade Finance products.

b. Application of Controls
   i. The controls to be applied in relation to complying with Sanctions, Embargoes and NPWMD include customer screening (both new and existing customers), transaction screening, payment screening and document screening.
   ii. The application of certain existing and appropriate financial crime controls may be considered relevant for the purpose of complying with national and regional sanctions and embargoes 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 ***Section 2 of the Core Principles Paper: Control Mechanisms***.

4.2 Documenting Decisions: As part of the application of controls in 4.1 b) above, FIs are expected to have procedures and processes in place to allow staff to record the basis of their decision in respect of any risk indicators or assessments of transaction risks that arise at any stage of a transaction. FIs are also expected to ensure that those comments are kept as part of the transaction audit trail for review as part of the control effectiveness and quality assurance processes, as well as evidence for audit and regulatory purposes.

5. Challenges

5.1 One of the most significant hurdles to effective enterprise wide FCR management is the controls on data protection and cross border information exchange. Such controls restrict the ability of FIs, as parties to a trade transaction, from accessing the relevant information required for due diligence on other parties. This will impact upon the effectiveness of transaction monitoring and screening.

5.2 Differing jurisdictional standards may impede global standardisation of due diligence requirements in Trade Finance transactions. Additionally, differing jurisdictional standards may cause some jurisdictions to have less stringent FCR controls than others. Such differences can lead to issues in respect of reliance on parties' systems and controls to conduct appropriate due diligence.

5.3 Differences in the scope and application of sanctions by various jurisdictions, which may create disparate or conflicting compliance or legal obligations, may present challenges for FIs relating to specific transactions and the assessments of a Customer or Non-Customer Relationship Bank in relation to FCC systems and controls.

5.4 Price verification for financial crime control purposes is difficult for FIs. 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 or the specific quality of the goods involved. Further, many products are not traded in public markets and there are no publicly available market prices. Even where goods are publicly traded, the current prices may not reflect the agreed price used in any contract of sale or purchase and these details will not usually be available to the FIs involved due to the competitive sensitivity of such information.

5.5 Dual use items are goods, software, technology, documents and diagrams, which may have both civil and military applications. Identification of dual use goods in a trade transaction is challenging given their possible complex and technical nature. While FIs may be in a position to identify obvious dual use goods; corporates, customers, Customs and export licensing agencies are better able to make this determination.

A FI's RBA should give guidance and provide regular training to staff involved in relationship management, transaction processing and any others who are involved in transactions on a regular basis (this should include Front Office and Middle Office staff involved in the transactions). Guidance and regular training may include how to perform an analysis of pricing for those goods where reliable and up-to-date pricing information can be obtained, how to identify where a unit price would be seen as obviously unusual and the escalation process that should be followed. The same applies to dual use goods. Staff should be aware of dual use goods issues, as well as the common types of goods which have a dual use and should attempt to identify dual use goods in transactions wherever possible.

5.6 Any methods used to hide the ultimate user of a product (such as through the use of intermediaries or the ultimate application or use of a product) often present a FCR in Trade Finance. Transactions involving multiple parties and transfers of ownership may disguise the true nature of a transaction, where such information may not be apparent to the FIs involved in that transaction.

5.7 FIs need to conduct significant work to ensure that all FCRs are routinely considered while processing Trade Finance transactions. Staff managing FCR at various levels in different departments require continuous training on how to identify potentially suspicious transactions.

5.8 It needs to be recognised that FIs around the world, especially those located in developing countries, are at different levels of maturity as far as the identification and application of FCR, CDD and Sanctions risks policies

and the implementation of appropriate mitigation processes required (variations in the level of sophistication of FCR systems and processes in FIs can be extreme, even within a single country). A FI's Risk Based Assessments of customers and transactions therefore need to take these country and regional differences into account when determining the level of risk mitigation and controls that are required to meet their principal regulators' expectations. Conversely, regulators need to be cognisant of these variations which will affect a FI's risk mitigation policies and processes to meet the risks in their geographical counterparty profile.

6. Recommendations

6.1 It is recommended that Governments, FIs, Trade Bodies and international Trade Logistics providers work together to counter the threat of financial crime within Trade Finance. This includes the ability of FIs to aggregate data freely across borders to identify, detect and prevent Financial Crime. All parties in the public and private sectors should ensure that there are clear data information exchange protocols. In order to support the cross border, enterprise wide exchange of information and data, co-operation and joint action is required by governments and other relevant authorities to ensure that laws relating to data protection data privacy, the duty of confidentiality and any other relevant legislation do not impede the exchange of information in support of FCR management.

These recommendations include:

a. The provision and maintenance, by relevant government authorities, of up to date suitably standardised lists of sanctioned entities and individuals, including appropriate identification data points and other relevant information to facilitate (i) effective screening and searching against customer databases and (ii) efficient and effective screening of transactions and relevant parties and information by FIs and other relevant stakeholders involved in the detection and prevention of Financial Crime.

b. 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 relate to "Dual Use" goods. These details should ideally be capable of being integrated into electronic processing systems.

c. The availability of effective "Help Desks" within relevant government authorities to respond to queries of a technical nature in relation to sanctions and in particular dual use goods. Such responses must be timely enough not to impact adversely the FI's obligations under the trade transaction or to alert potential perpetrators.

d. The publication by the relevant authorities of the names of individuals and entities that have been denied export licences with the reasons for denial or who have been involved in criminal activities (including corruption) involving Trade Finance.

e. Continuous dialogue between the public and private sectors in relation to the identification and dissemination of typologies and previously used risk indicators in respect of Trade Finance.

f. The timely 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, as well as sharing of the typologies and giving feedback in relation to the SARs filed.

2. Control Mechanisms

1. Introduction

1.1 The Trade Finance Principles Paper sets out the background to Trade Finance and addresses associated FCRs.

1.2 ***Appendices I, II, III, and IV***, dealing with DCs, BCs, SBLCs, Guarantees and Open Account, set out the extent to which FIs already address the challenges posed by Financial Crimes Risk, 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 non-proliferation, weapons of mass destruction and dual use goods.

1.3 This section of the Principles paper highlights the control mechanisms considered most relevant to FIs and should be read in conjunction with the guidance on FCRs within the Core Trade Finance Principles paper and the other sections and appendices.

1.4 The Financial Action Task Force ("FATF") Proliferation Report[11] is a significant reference source. It identifies the important role of a number of stakeholders and acknowledges the difficulties which FIs face in detecting proliferation financing.

1.5 It is a requirement that FIs retain all evidence relating to FCR decisions made in the processing of all transactions, which must be kept with the transaction records and be readily available for review post transaction completion.

1.6 Risk based post transaction reviews and quality assurance processes should be established to determine, within a reasonable timeframe, if transactions have been appropriately evaluated and risk managed both with respect to Operational risk and FCR requirements, and that data in a CDD file is valid and current.

1.7 FIs need to be able to demonstrate that they have robust control review processes and procedures for alert management in place. This requires that there are records of the decision making process and the review of those decisions being checked and challenged where appropriate.

2. Customer Due Diligence

2.1 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. FIs will have a RBA in their policies and procedures around the on boarding and retention of customers. These will reflect, at the very least, the requirements of FATF Recommendation 10,[12] the Interpretive Note to Recommendation 10 and an FI's primary regulators' requirements on CDD.

2.2 CDD for trade account customers, both borrowing and non-borrowing, requires the FI to have an understanding of the business model, the principal counterparties, the countries where the counterparties are located and the goods or services that are exchanged, as well as the expected annual transaction volumes and flows.

[11] FATF Proliferation Report (2008), http://www.fatf-gafi.org/media/fatf/documents/reports/Typologies%20Report%20on%20Proliferation%20Financing.pdf

[12] FATF Recommendation 10, Text of Recommendation and Interpretative Note, http://www.un.org/en/sc/ctc/docs/bestpractices/fatf/40recs-moneylaundering/fatf-rec10.pdf

2.3 Depending on a FI's RBA and its risk appetite, Enhanced Due Diligence (EDD) may be required where the countries, products or customers involved are deemed to be High Risk, or where the goods are seen as being high risk or of a dual use nature.

2.4 Relevant country, goods and principal counterparty names should be made available to trade processing staff so that they can easily check that a transaction is within the agreed profile of the customer. A RBA to the provision of counterparty names should be adopted due to the practicalities for customers with multiple counterparties.

2.5 The CDD processes will be expected to include "feed-back loops" where a trigger event in a transaction or normal review process leads to new information or questions about a relationship. This updating of the CDD profile ensures that the information in the CDD profile is current. The event reviews may also lead to the status of the relationship with the customer being escalated for decisions related to additional controls being applied or the exiting of the customer.

3. Name Screening

3.1 The application of FCC controls provides a good foundation for certain sanctions controls. FIs generally have screening systems or processes in place, which are designed to match information in processed transactions against relevant lists. This process can be applied to ensure that the transactions such as those described in the appendices do not violate UN or applicable local sanctions against named individuals and entities.

In order to achieve this, FIs need to refer to relevant external sources or subscribe to competent information providers.

3.2 Clearly, the effectiveness of this control is dependent upon the availability, accuracy, quality and usability of the source lists which contain the details of target names. A very substantial practical issue already faced by FIs is the volume of false hits which can occur in their systems as a result of automated screening. A false hit is where a partial or unconfirmed match occurs between bank data and the data in the relevant list. A partial match will occur where target names have similar or common elements with non-targets. An unconfirmed match, also known as a "False Positive", would occur if the names match, but investigation confirms that the underlying identities are not the same.

3.3 FIs should have robust internal list management procedures in place to assist in reducing the numbers of repeat "False Positive" hits. This is to help reduce the possibility of too many false positives obscuring true positive hits and causing reviewers to miss actual issues.

4. Activity Based Financial Sanctions

4.1 Where the target of the relevant sanctions is indicated by industry, activity, geographical location (not country specific) or related to a sanctioned entity and not specifically identified by name, it makes any effective screening of a transaction by FIs exceptionally difficult, regardless of whether automated or manual processes are used.

4.2 FIs should 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.

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

a. The Wassenaar Arrangement,[13] 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.

b. UN Security Council Resolution (UNSCR) 1737 (2006)[14]

c. FATF Guidance including:

- Implementation of financial provisions of UNSCRs to counter the proliferation of WMDs (updated 2013)[15]
- FATF Guidance regarding the implementation of activity-based financial provisions of UNSCR 1737 (October 2007)[16]
- FATF report on Proliferation Financing (June 2008)[17]
- FATF Combating Proliferation Financing: Status Report on Policy Development and Consultation (February 2010)[18]

d. Other supporting documents[19]

4.4 FIs 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.

4.5 As with name screening (3.3), FIs should have robust list management processes and procedures in place to assist in reducing the numbers of repeat "False Positive" hits. This is to help reduce the possibility of too many false positives obscuring true positive hits and causing reviewers to miss actual issues.

5. Export Controls

5.1 It is the commercial counterparties to a trade transaction that, in the first instance, should determine whether an export licence is required and that should obtain such a licence if it is required. FIs are generally not in a position to determine, at any stage in a trade transaction, whether an export licence is required, or whether the commercial counterparties to the trade have obtained a valid export licence.

5.2 The documentation required for preparing a trade financing arrangement rarely contains a detailed description of the product, much less information as to whether there are any third-country licencing requirements attached to the product. Relevant government agencies, on the other hand, may be in a position to determine the need for any necessary licences and to verify whether they have been duly obtained.

[13] The Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies, http://www.wassenaar.org/controllists/index.html
[14] UN Security Council Resolution (UNSCR) 1737 (2006), https://www.iaea.org/sites/default/files/unsc_res1737-2006.pdf
[15] FATF (2013), http://www.fatf-gafi.org/media/fatf/documents/recommendations/Guidance-UNSCRS-Prolif-WMD.pdf
[16] Consolidated with FATF Guidance: The Implementation of Financial Provisions of United Nations Security Council Resolutions to Counter the Proliferation of Weapons of Mass Destruction (2013), http://www.fatf-gafi.org/documents/documents/unscr-proliferation-wmd.html
[17] FATF (2008), http://www.fatf-gafi.org/media/fatf/documents/reports/Typologies%20Report%20on%20Proliferation%20Financing.pdf
[18] FATF (2010), http://www.fatf-gafi.org/media/fatf/documents/reports/Status-report-proliferation-financing.pdf
[19] http://www.iaea.org/DataCenter/index.html

5.3 Where highly structured Trade Finance transactions are concerned, or where EDD is conducted as a matter of routine, it may be appropriate for the FIs involved to obtain appropriate assurances that export licencing requirements have been satisfied.

6. Limitations

6.1 The challenge facing FIs in their efforts to put in place suitable controls aimed at preventing or discovering financial crime in their trade finance business is considerable, particularly in relation to activity based financial sanctions. The following points are especially relevant.

a. Payments made through FIs in support of Open Account trade (which accounts for approximately 80% of all international trade) can only be screened by reference to the disclosed name data.

b. The successful facilitation of international trade relies on the adherence to recognised international banking standards. Following initial CDDCDD and once a customer transaction has been accepted and initiated, the remaining activities conducted by the participating FIs need to be completed within relevant specific timeframes.

c. Information or details within the documentation presented to FIs may be insufficient to disclose the exact nature of the transaction. Many trade transactions are only a part of a related chain of transactions and the FIs involved will have a view for that transaction only. Provided that there are no alerts that would indicate an issue with the transaction, a FI would continue with the transaction if it met the requirements of the customer CDD profile.

d. When handling BCs, in particular, a detailed examination of documents accompanying the BC is not possible. This is fundamentally different to the position under DCs, SBLCs, and Guarantees. This is because there is no initiating document in a BC transaction as there is in a DC or Guarantee or SBLC transaction (refer to Appendix II 6. 5. b.)

e. 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.

f. The clarity of any additional information derived from a sanction screening hit or a FC risk indicator review. Often the information is ambiguous or contradictory. (Refer to Challenges and Recommendations in this paper).

6.2 Interpretation of “dual use” requires a degree of technical knowledge that DC, SBLC, and Guarantee FI staff 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 FI to understand the varying applications of dual use goods will be virtually impossible. It would be impracticable for FIs to employ departments of specialists for this purpose as in doing so they would need to replicate comprehensive scientific research facilities.

6.3 FIs are only one of the relevant stakeholders. Whilst FIs 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 or discovery of the relevant targets in this area.

3. Escalation Procedures

1. Introduction

1.1 The Trade Finance Principles Paper sets out the background to Trade Finance and addresses FCRs.

1.2 This section provides guidance on the specific application of controls by Banks[20] in the context of escalation procedures.

2. Three Lines of Defence

2.1 Banks involved in a trade transaction should ensure that they are cognisant of the Three Lines of Defence model, and that they implement the model in accordance with their RBA.

2.2 The first line of defence refers to business operations. Specifically, businesses are responsible for ensuring that a risk and control environment is established as part of day-to-day operations. Line management should thus be adequately skilled to create risk definitions and perform risk assessments. The first line of defence provides management assurance and informs business governance committees, by identifying risks and business improvement actions, implementing controls and reporting on progress.

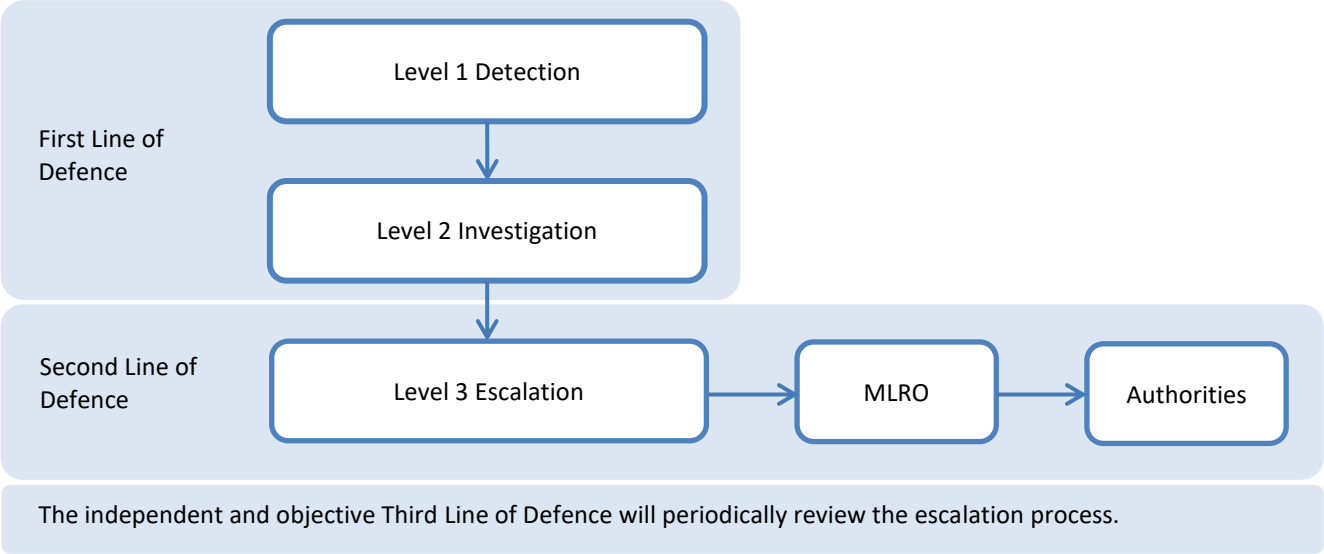
2.3 The second line of defence refers to the oversight functions. The oversight functions set company boundaries by drafting and implementing policies and procedures. They are also responsible for guidance and direction for implementing their policies and for monitoring their proper execution. They provide oversight over business processes and risks.

2.4 The third line of defence refers to internal audit. The role of the third line of defence is to provide independent, objective assurance, as well as consulting activities designed to add value and improve a company's operations. They help the company to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

[20] 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 Escalation Procedures

3. Application

3.1 To apply the three lines of defence model into their Trade Finance business, FIs may adopt the following model:



3.2 For the application of the three lines of defence model in Trade Finance, banks can build on existing transaction processes to add in at key points as described in Appendices I, II and III. At each stage of an intervention, the decision to refer or continue and the rationale needs to be recorded and kept on file. Details of the escalation, the review and decision rationale and action are kept for all stages of the escalation process up to and including the decision at Level 3 to record as an Unusual Transaction Report (internal record or however named) or to file a Suspicious Activity Report (SAR or STR) with the relevant Authorities.

4. Glossary

1. Terms

1.1 This section is a glossary of selected terms used generally in Trade Finance and in this Trade Finance Principles Paper:

- **Acceptance:** The act of giving a written undertaking on the face of a usance bill of exchange or draft, 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 Bills for Collection, 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:** The act of conveying the terms and conditions of a Documentary Credit, Guarantee or SBLC to the beneficiary

- **Advising Bank:** The Advising bank is a Correspondent Bank or a Non-Customer Bank of the issuing bank, usually located in the beneficiary's country. It is the bank nominated in the DC to authenticate and advise a DC, SBLC or Guarantee to the Beneficiary in accordance with the requirements of ICC Rules.

- **Amendment:** An alteration to the terms of a Documentary Credit or SBLC or Guarantee. Amendments must be issued by the issuing bank and advised to the beneficiary.

- **Anti-Boycott measures:** This term refers to measures undertaken by FI's to ensure that Trade Finance transactions do not become subject to non-sanctioned embargoes designed to isolate or create economic disadvantages for certain countries, where there is countervailing legislation that they are subject to.

- **Applicant:** The person or entity who applies to their bank to issue a Documentary Credit, SBLC or Guarantee. In the majority of DCs issued, the applicant is a buyer or importer of goods or services.

- **Back-to-Back Credit:** A Documentary Credit issued against the security of another Documentary Credit (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 or services will exist since this is usually where the beneficiary of the Master credit makes a profit.

- **BAFT: (**The Bankers Association for Finance and Trade) is a leading international financial services trade association whose membership includes a broad range of financial institutions throughout the global community. BAFT helps bridge solutions across financial institutions, service providers and the regulatory community that promote sound financial practices enabling innovation, efficiency, and commercial growth. As a worldwide forum for analysis, discussion, and advocacy in international financial services, BAFT engages on a wide range of topics affecting transaction banking, including Trade Finance, payments, and compliance. BAFT member banks provide leadership to build consensus in preserving the safe and efficient conduct of the financial system worldwide.

- **Beneficiary:** A payee or recipient, usually of money. A party in whose favour a DC, SBLC or Guarantee is established. The beneficiary is usually the exporter or seller of the goods or services.

- **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 a Documentary Collection.

- **Bill of Exchange or Draft:** 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.

- **BPO:** Bank Payment Obligation is an irrevocable undertaking by a bank to make a payment as specified in an agreed baseline of an electronic trade transaction made in accordance with the ICC BPO Rules, Publication 750E, in an approved TMA supplied controlled system.

- **Clean Payment**: Used to describe a payment which is handled without the presence of any underlying commercial documents.

- **Collecting Bank**: In Bills for Collections it is the Bank in the drawee's (buyer's) country that is instructed to collect payment from the drawee.

- **Collection Order:** Form submitted, with documents, to the remitting bank by the principal or exporter with his instructions. Also known as Collection Instruction.

- **Connected Party**: Person or entity that has some connection with the customer through having mutual managers, directors, owners, partners etc.

- **Confirm or Confirming:** Act of a bank, other than the issuing bank, assuming the liability for payment, acceptance or negotiation of conforming documents presented under a Documentary Credit or SBLC.

- **Confirming Bank**: Bank acting on the nomination of the issuing bank to act as the paying, accepting and paying on due date against conforming documents submitted by the beneficiary.

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

- **Credit:** Where a bank lends money or assumes a contingent liability (that is providing a credit facility).

- **Default undertaking:** An irrevocable obligation made by a bank to make a payment should a named party fail to carry out or complete a stated activity within or by a specified time or date and in accordance with the stipulated documentary requirements to fulfil the claim for payment.

- **Discounting:** Act of purchasing or prepaying an accepted bill of exchange or documents presented under Documentary Credit.

- **Discrepancy:** Any deviation from the terms and conditions of a Documentary Credit, SBLC or Guarantee, or from international standard banking practice or any applicable ICC rules found in the documents presented there under, or any inconsistency between the documents themselves.

- **Documentary Collection:** See Bill for Collection (BC)

- **Documentary Letter of Credit (DC):** 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. There are three types of commercial DC**: Sight DCs, Acceptance DCs** and **Deferred Payment DCs** (the latter two types are often referred to as "Usance DCs" whereby payment is to be made at a date determined by the terms of the credit, e.g.: 120 days after Bill of Lading Date. A Deferred Payment DC is similar to an Acceptance DC except that no Bills of Exchange or drafts are presented or accepted. The issuing bank is responsible to make payment on the **Due Date**.

- **Documents against Acceptance (D/A):** Instruction used in Bills for Collection for documents to be released to the drawee in exchange for the drawee's acceptance of the Bill of Exchange, Draft or an irrevocable promise to pay at a determinable future date.

- **Documents against Payment (D/P):** Instruction used in Bills for Collection for commercial 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. (see Bill of Exchange above).

- **Drawee:** The party from whom payment is expected.

- **Drawer:** The party who is demanding payment

- **Due Date**: Maturity date for payment.

- **Due Diligence**: the risk based process for identifying and knowing the customer; the risk based controls in relation to parties who may not be customers. Requires gathering and storing of information about the company, the managers, owners and beneficial owners (silent partners) if any, trading partners, countries and goods or services traded.

- **Enhanced Due Diligence:** Additional level of questioning required to be answered where initial investigation of a customer or potential customer or counterparty has raised issues related to "risk indicators" or where the RBA of the firm has identified that further CDD information is required to satisfy the requirements to fulfil adequate due diligence in relation to that customer.

- **Embargoes:** An embargo restricts commerce of exchange with a specified country. An embargo is usually created as a result of unfavourable political or economic circumstances between nations. The restriction looks to isolate the country and create difficulties for its governing body, forcing it to act on the underlying issue.

- **Export Licence:** A permit, either electronic or on paper, issued by a government department or licensed body, including customs agencies, allowing the export of controlled items under stated conditions. Also used in general when a country has Foreign Exchange controls.

- **FATF**: The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The

FATF is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

The FATF has developed a series of **Recommendations** that are recognised as the international standard for combating money laundering and the financing of terrorism and proliferation of weapons of mass destruction. They form the basis for a co-ordinated response to these threats to the integrity of the financial system and help ensure a level playing field. First issued in 1990, the FATF Recommendations were revised in 1996, 2001, 2003, and most recently in 2012 to ensure that they remain up to date and relevant, and they are intended to be of universal application.

- **Financial Crime**: Any criminal activity that involves the financial system or the use of money or anything that is of value, in order to perpetrate or assist in the perpetration of a criminal activity.

- **FCR (FCR or FC risk):** Are the risks associated with criminal activities involving the financial system. These risks are identified by a bank's risk assessment of its business and are then managed by the application of the risk control framework the bank uses to mitigate those risks.

- **Guarantee:** An undertaking by a bank to make payment to a named beneficiary against a formal complying claim that another named party has failed to perform a specified action

- **Guarantor**: The bank issuing the Guarantee

- **International Chamber of Commerce (ICC):** ICC is the world's largest business organization with a network of over 6.5 million members in more than 130 countries. ICC works to promote international trade, responsible business conduct and a global approach to regulation through a unique mix of advocacy and standard setting activities – together with market leading dispute resolution services. ICC's members include many of the world's largest companies, SMEs, Business associations and local chambers of commerce.[21]

- **Import Licence**. A permit, either electronic or on paper, issued by a government department or licenced body, including customs agencies, allowing the import of controlled items under stated conditions. Also used in general when a country has Foreign Exchange controls.

- **ISP98:** The International Standby Practices ISP98, ICC Publication No. 590.

- **Issuing Bank or Issuer:** The bank that opens a Documentary Credit or SBLC or Guarantee at the request of its customer, the applicant.

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

- **Negotiation: DCs:** The purchase by a nominated bank of drafts (drawn on a bank other than the nominated bank) or documents under a complying presentation under a Documentary Credit, 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.

- **Negotiation: BCs:** The purchase or discounting of the Bill of Exchange or Draft of a Collection by the Remitting Bank

[21] Definition from www.iccwbo.org

- **Network banks:** Are non-customer banks and have no accounts, facilities or dedicated Relationship Manager. They are sponsored by a global line of business and interactions are limited to document exchanges and restricted SWIFT RMA message interactions. The settlement of any transaction is decoupled from the document exchange and always made via a customer bank.

- **Nominated Bank**: A bank requested to carry out a specified action in accordance with the UCP or ISP 98

- **NPWMD**: This term refers to the prevention of proliferation of nuclear, chemical, and biological weapons, as well as their means of delivery.

- **Opening Bank**: See Issuing Bank.

- **Presentation:** In Documentary Credit, SBLC and Guarantees, it is either the delivery of documents under a Documentary Credit and SBLC or Guarantee to the issuing bank or guarantor or to the nominated bank, or the documents so presented. In Bill for Collection, it is the act of a collecting bank, performing in the capacity of presenting bank, which contacts the drawee for payment or acceptance in accordance with the collection instruction.

- **Presenting Bank:** Under Documentary Credit SBLC and Guarantees, it is the bank that presents drafts and or documents or a claim for payment. In Bill for Collection, 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.

- **Red Flag**: So called from FATF and US Treasury typologies. Event triggers or indicators that are used to identify when a review or escalation activity needs to take place. Firms identify, (through their RBA processes, activities, data, or risk indicators) their own risk indicators for transactions, enhanced CDD requirements and escalation points. (For further reference; please see the BAFT issued Guidance for Identifying Potentially Suspicious Activity in Letters of Credit and Documentary Collections, March 2015.)[22]

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

- **Related Party**: Person or entity that is a subsidiary, associate, that has a relationship to the customer that is not at arm's length.

- **Relevant Party:** Person or entity that is identified as appropriate to carry enhanced due diligence screening when the name appears in related documents or in research activities during the on boarding or review processes.

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

- **RBA (RBA)**: The RBA relates to the steps taken for individual customers or transactions, based on that FI's analysis of the risks in relation to the parties involved, the type of transaction, monetary value of the

[22] BAFT (2015), https://baft.org/policy/document-library

transaction and other factors that may either increase or reduce the risk of financial crime in any given transaction. The Wolfsberg Group has issued general guidance on a RBA[23] in relation to Trade Finance.

- **Sanctions**: An official order, such as, but not limited to, the stopping of trade, which is taken against a country in order to make it obey international law.

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

- **Screening**: Processes, usually automated, whereby lists of names, entities, persons or countries derived from various official sanctions or prohibited persons lists are used to identify possible fraud, sanctions or other concerns with respect to a relationship or transaction.

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

- **Standby Letter of Credit:** A written undertaking by a bank (issuing bank) at the request of the applicant, to issue an irrevocable undertaking in favour of a named beneficiary.

- **SWIFT:** The Society for Worldwide Interbank Financial Telecommunication, headquartered in Belgium, is a global member-owned cooperative and is the world's leading provider of secure financial messaging services.

- **SWIFT RMA:** The RMA (Relationship Manager Application) is a messaging capability that enables members of the SWIFT network to exchange messages over the network. The use of RMA is mandatory for sending and receiving any SWIFT message**. RMA Plus:** Is a more restrictive arrangement allowing banks to limit the message types that can be exchanged between "correspondent network banks."[24]

- **Trade Based Money Laundering**: Trade Based Money Laundering ("TBML") has become a widely used term. It covers a broad spectrum of financial and other services, including those financial services referred to as Trade Finance, but also transactional activities across current and deposit accounts, payments etc., which are not in the purview of Trade Finance operations of FIs. Typologies given by regulators in respect of TBML often describe in detail the use of "Funnel Accounts" as a part of a TBML typology. Detection of such funnel account operations may only be discovered by a bank's account activity monitoring systems and programme, and rarely through the trade transactions activity. Often the funnel accounts are not in the trade financing bank, with transfers of money from funnel accounts being made against false invoices or processes to bring the money into the account of the trade relationship in order to fund the legitimate trade transactions of the trading company. Often the trading company will have been taken over by the money launderers to facilitate the layering process.

- **Transaction Monitoring:** Process, either automated or manual, that is post transaction, whereby transactions are reviewed and assessed to identify if there are any suspicious or unusual activities or patterns in the customer's behaviours.

[23] Wolfsberg Statement - Guidance on a Risk Based Approach for Managing Money Laundering Risks (2006), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg_RBA_Guidance_(2006).pdf

[24] See the Wolfsberg Group's "Guidance on SWIFT Relationship Management Application (RMA) Due Diligence" paper (2016), http://www.wolfsberg-principles.com/pdf/home/SWIFT-RMA-Due-Diligence.pdf

- **Transferable Credit:** Permits the beneficiary to transfer all or some of the rights and obligations under the Documentary Credit to one or more second beneficiaries. Not all DCs are transferrable. In order for a DC to be transferrable there must be a "Transfer clause" in accordance with the UCP, clearly noted in the text of the credit or by using the correct SWIFT message type, MT 720, 721.

- **TMA:** Transaction Matching Application is an independent electronic system operating a message platform in compliance with ISO 20022 which has transaction matching algorithms defined to manage a trade transaction in purchase order detail so that the seller and buyer can be confident that the order as placed is fulfilled. A bank or banks may add their Bank Payment Obligation to the transactions to provide certainty of payment. An example of a TMA is the SWIFT TSU (Trade Service Utility) provided as a service to member banks.

- **UCP 600:** ICC publication, Uniform Customs and Practice for Documentary Credits (2007 revision)

- **Unexplained Third Party**: Person or entity that appears in a transaction or payment instruction where there has been no previous identification of that person or entity in the structure or documentation relating to the transaction.

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

- **URDG 758**: ICC Uniform Rules for Demand Guarantees.

- **URC 725:** Uniform Rules for Bank to Bank Reimbursements

- **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), 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 DCs where the issuing bank agrees to pay for documents presented after waiving the presence of discrepancies in the documents.

- **Wolfsberg Group**: The Wolfsberg Group is an association of thirteen global banks which aims to develop frameworks and guidance for the management of FCRs, particularly with respect to Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies. The Wolfsberg Group consists of the following financial institutions: Banco Santander, Bank of America, Bank of Tokyo-Mitsubishi UFJ, Ltd, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JPMorgan Chase, Société Générale, Standard Chartered and UBS.

Appendix I: Documentary Credits

1. Introduction

1.1 The Trade Finance Principles Paper sets out the background to Trade Finance, as defined in Section 1 of the Core paper of this document, and addresses associated FCRs. 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.

1.2 This appendix provides guidance on the specific application of controls by Banks[25] in the context of Documentary Credits (DCs). It 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.

1.3 The controls fall into the following categories:

a. **Due Diligence:** Defined in this paper as:
   - the risk based process for identifying and knowing the customer;
   - the risk based controls in relation to parties who may not be customers.

   Given the range of meanings, reference will be made as necessary to appropriate risk based checks.

   Each bank's established CDD policies should designate which party to a trade transaction is the customer and therefore subject to the bank's due diligence process. It is not the responsibility of the bank to perform due diligence on all parties to a trade transaction. (Refer to Section 2.1 of the Trade Finance Principles, Core Paper)

   Banks should have risk based policies and procedures covering CDD, whereby all customers of the bank, which includes correspondent banks, will be subject to the bank's CDD procedures. Due diligence information should be made available to all areas handling Trade Finance customers and transactions, to enable them to understand the customer profile (including expected activity) and identify potential suspicious activity.[26]

b. **Review:** Defined as any process (whether manual or automated) to review relevant information available in a transaction relating to the relevant parties involved, documents and data presented and instructions received. Certain information can, and should, be reviewed and checked before transactions are allowed to proceed.

   Reviewing activity, as described in this paper, equates to document checking where the documents and their contents are checked for conformity. Appropriate FCR checks should be done based on the information in the documents, transaction details and relevant information from the CDD profile. References to "review cycle" relate to the customer CDD review process whereby the relationship as a whole is "reviewed" on an agreed cycle, typically a one to three year cycle dependent upon the bank's risk assessment of the customer.

[25] 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 DCs

[26] *BAFT: Guidance for Identifying Potentially Suspicious Activity in Letters of Credit and Documentary Collections* (2015), https://baft.org/policy/document-library

c. **Screening:** Processes, usually automated, whereby lists of names, entities, persons or countries, derived from various official sanctions or prohibited persons lists are used to identify possible fraud, sanctions or other concerns with respect to a relationship or transaction.

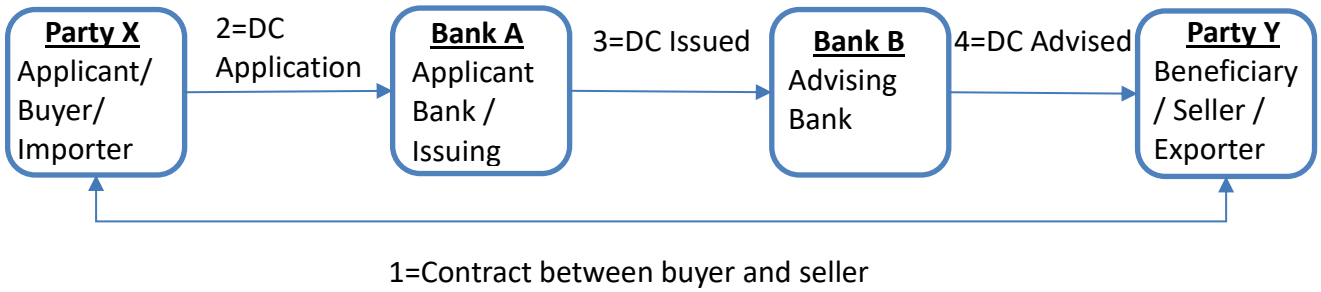
1.4 **Transaction Monitoring:** Defined as any activity to review completed or in progress transactions for the presence of unusual or potentially suspicious features. For Documentary Trade transactions, it should be recognised that it is difficult, if not impossible, to introduce any standard patterning techniques in relation to transaction monitoring processes or systems. This is due to the range of variations which are present even in normal trading patterns. The significant presence of paper documents in this type of trade, and the continuing difficulty of global trade businesses to fully adopt standardised electronic solutions, will continue to see a need for manual input even in transaction monitoring. While the latest technological developments may give rise to the possibility of automation and pattern based recognition systems, these systems are still under development, are unproven and represent investment requirements that will be attainable only to larger banks. A summary of 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 **Section 4: Glossary of Terms**.

1.5 It is important to note that with DCs the banks typically operate in accordance with ICC Publication No. 600 – Uniform Customs and Practice for Documentary Credits.[27] 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***).

The checking of information in documents to meet the requirements of the DC under UCP and International Standard Banking Practice is not the same as checking documents for AML or sanctions purposes. The UCP does not require the line by line detailed examination of all documents presented, nor of the printed terms and conditions on documents such as transport, insurance and other "official" documents presented. The AML checks will be based on the RBA of a bank and its instructions and education given to trade operations and related staff.

2.

Simplified Scenario - DC



2.1 As depicted in the diagram, Party X is purchasing goods from one of their suppliers, Party Y. Party X is the customer of Bank A, and Party Y may or may not be a customer of Bank B.

[27] "The Uniform Customs and Practice for Documentary Letters of Credit (2007 Revision), ICC Publication No. 600

2.2 Prior to shipping the goods, Party Y wants to know that they will be paid once the shipment has been made, so Party Y requests that a DC be issued in its favour, with payment to be made only against the receipt of stipulated documents related to the shipment of goods by Party X's Bank, Bank A.

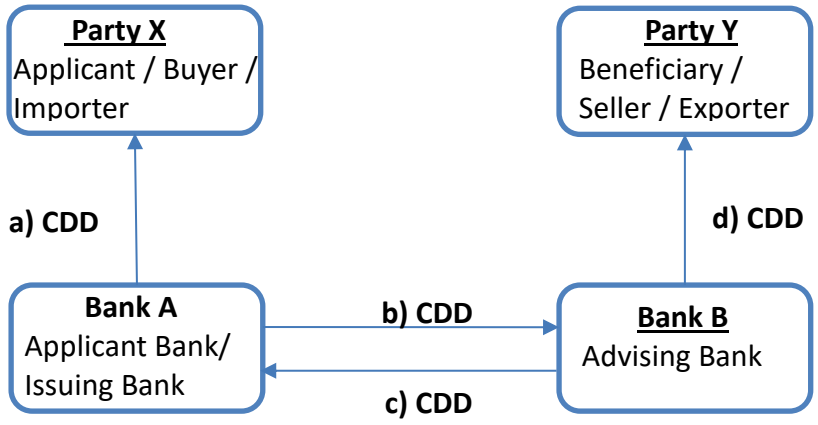
2.3 Party X instructs Bank A to issue a DC in favour of a Seller, Party Y.

2.4 Bank A selects Bank B (its correspondent bank or Party Y's nominated bank) to advise the DC to Party Y locally. After the presentation of documents by Party Y through Bank B, and having found the documents to be in order, Bank A will pay under the DC.

2.5 An overview of the due diligence and reviewing activities is provided in the tables below.

3.

Due Diligence Overview - DC



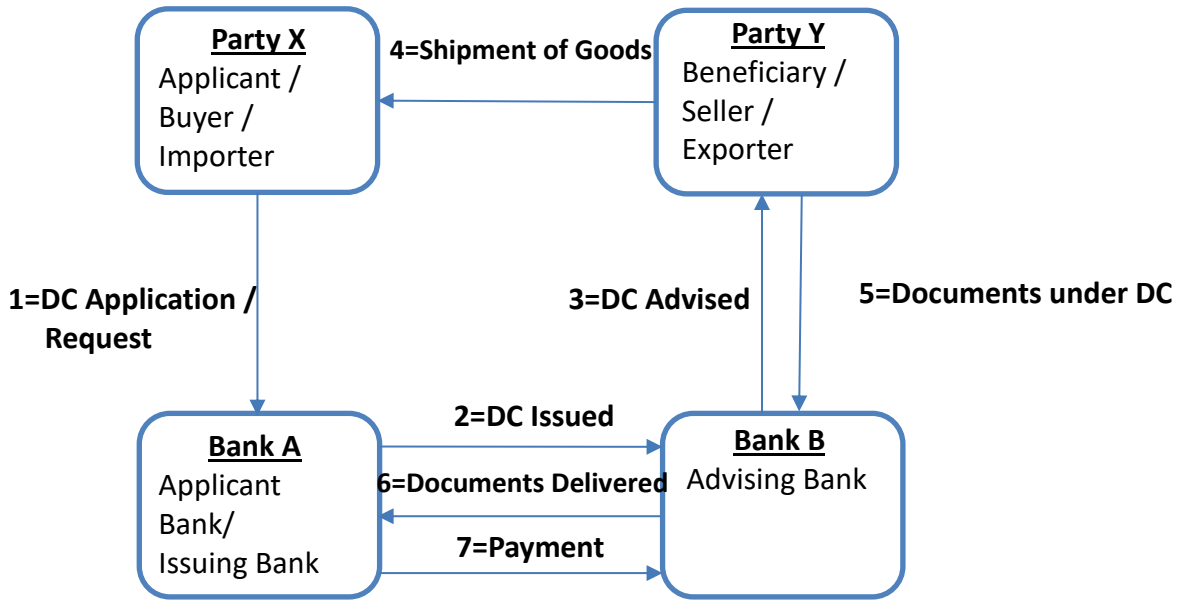
3.1 The banks conduct due diligence, which usually follows the pattern described below:[28]

a. Bank A will conduct due diligence on Party X (when on boarding and during the account CDD review cycle)
b. Bank A should conduct appropriate risk based due diligence on Bank B and at CDD review
c. Bank B should conduct appropriate risk based due diligence on Bank A and at CDD review
d. Bank B will conduct risk based due diligence on Party Y where Party Y is B's customer
e. Bank B will conduct appropriate risk based control checks on Party Y where Party Y is not B's customer

[28] This information is obtained prior to transactional activity and the data is made available to the processing department during the transactional verification process.

4.

Review Activity Overview - DC



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

a. Bank A will review the DC application from Party X (before agreeing to issue DC)
b. Bank B will review the DC as issued when received from Bank A (before agreeing to advise it)
c. Bank B may review the documents presented by Party Y (when receiving them under the DC from Party Y) applying a RBA
d. Bank A will review the documents and payment instructions presented by Bank B (before paying Bank B - who will in turn pay Party Y)
e. Bank A and Bank B will screen the payment which they make or receive as per their financial crime policy, procedures and controls.

5. Controls undertaken by Bank A

5.1 **Party X Due Diligence:**

a. Bank A should conduct due diligence[29] as appropriate on Party X (who is a customer of Bank A) prior to issuance of the original DC. 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 DC applied for.

[29] Identification, verification screening, CDD (and credit approval)

b. This would be available for use by Trade Finance operations for confirmation that each transaction is in accordance with the CDD profile.

c. Bank A's due diligence process should include, where DC facilities are required, the following questions:
   - The countries in relation to which Party X buys and sells
   - The goods traded
   - The type and nature of parties with whom Party X does business (e.g. customers, suppliers, etc. This does not imply that a counter party CDD is required).

Based on the responses to these questions, it may be required to conduct EDD.

d. Additionally, Bank A can be expected to have a RBA to obtaining information on a transactional basis about 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).

5.2 **Enhanced Due Diligence (EDD):**

a. An enhanced due diligence process should be applied, within the normal process of due diligence, 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 (See the FATF 40 Recommendations,[30] Section 10 Guideline H).

b. An EDD process should be designed to ensure clear understanding of the trade cycle, to gain assurances regarding customers' compliance systems (which could include but are not limited to cross border controls and licencing regulations) and to ensure understanding of payment flows.

c. Trigger Events:
   There may be trigger events during the on boarding stage or during the ongoing review of a relationship or during the transaction process

   - The nature of business and the anticipated or actual transactions as described and disclosed in the initial due diligence stage or during the relationship may not necessarily suggest a higher risk category. However if, during the course of any transaction, any additional risk factors become apparent, this may warrant additional or enhanced due diligence.
   - This due diligence may include third parties (i.e. parties not associated with Bank A, intermediaries or traders using back to back or transferable DCs to unconnected other parties).

5.3 **Bank B Due Diligence:**

a. Bank A should undertake appropriate due diligence on Bank B, depending on the nature of the relationship between Bank A and Bank B. The due diligence will support an on-going relationship with Bank B, which will be subject to a relevant risk based review cycle. Therefore, additional due diligence on Bank B for any subsequent transactions is not required.

[30] FATF 40 Recommendations (2012), http://www.fatf-gafi.org/publications /fatfrecommendations/documents/fatf-recommendations.html

b. See the Wolfsberg Correspondent Banking Principles[31] and FAQs for guidance with respect to the level of due diligence to be performed in relation to Bank B.

5.4 **Reviewing of transactional information:**

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

a. Receipt of the initial DC application (and any amendments) from Party X

b. Receipt and checking of documents presented by Party Y through Bank B

c. Payment

d. At other times where material changes to the transaction occur.

In practice, once a DC has been issued, Bank A has an obligation to complete the transaction. Only if subsequent reviewing activity shows a positive screening match would Bank A be in a position to stop the transaction. Depending on local law there may be circumstances where fraud would also allow the transaction to be stopped.

The documentation presented to Bank A will be examined to ensure compliance with the DC and in accordance with the UCP and international banking standards.[32] This review does not 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 DC application**

Appropriate reviews should be conducted by Bank A in relation to the Documentary Credit application when received from Party X, which takes account of the following:

Sanctions and 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 goods are shipped from, disclosed transhipment points and destination points
- All other names appearing in the DC

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 if:

[31] Wolfsberg Anti-Money Laundering Principles for Correspondent Banking (2014), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Correspondent-Banking-Principles-2014.pdf

[32] The relevant ICC Rules for DCs are "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".

- The type and quantity of goods, and value of transactions, is not inconsistent with what is known of Party X

The seller (Party Y)

- On the face of the application they are the kind of counterparty which is consistent with what is known of Party X and their business

Risk indicators and Unusual Activity

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 to issuance of the DC, but make a record of the circumstances that allowed the DC to be issued for review purposes
- Depending on circumstances, local regulatory and legal requirements Bank A must file a suspicious activity report to the appropriate Authority and take any additional action as required by local laws and regulations.

- **Stage 2: Reviewing the documents presented under the DC**

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

- The lapse of time between stage 1 and stage 2, since this can raise the need for a further check of any relevant sanctions or binding local regulations

- Local legal requirements

- The screening of all names and parties related to the transaction against current applicable lists

- The extent to which documents presented match the information already checked in the DC at the time of presentation. If the information matches, it means that the reviewing would have already taken place when checking the DC, therefore relevant AML reviewing activities do not need to be repeated.

- Checking of the received documents against any Risk indicators or scenarios that Bank A has determined to apply in its RBA.

- Decline the transaction if enquiries do not provide reasonable explanations and, subject to circumstances and local legal requirements, submit an internal suspicious activity report to the appropriate department that handles FCRs.

- Depending on circumstances, local regulatory and legal requirements Bank A must file a suspicious activity report to the appropriate Authority and take any additional action as required by local laws and 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 requests transfer of funds to an account with a bank not involved in the DC, that bank's name should be subjected to screening by Bank A.

5.5 **Monitoring:**

a. 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

5.6 **Ongoing Due Diligence by Bank A:**

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

b. There should be ongoing reviews of the relationship on a periodic basis.

6. Controls undertaken by Bank B

6.1 **Due Diligence:**

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

b. Bank B should undertake appropriate due diligence on Bank A. The due diligence may support an on-going 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.

c. 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 DC received from Bank A.

d. See the Wolfsberg Correspondent Banking Standards[33] and the Wolfsberg Guidance on SWIFT Relationship Management Application (RMA) Due Diligence[34] for guidance with respect to the level of due diligence to be performed in relation to Bank A.

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

[33] Wolfsberg Anti-Money Laundering Principles for Correspondent Banking (2014), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Correspondent-Banking-Principles-2014.pdf

[34] Wolfsberg Guidance on SWIFT Relationship Management Application (RMA) Due Diligence (2016), http://www.wolfsberg-principles.com/pdf/home/SWIFT-RMA-Due-Diligence.pdf

f. However, Bank B may not have any relationship with Party Y because Bank A could have 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 Finance business or the processing of DCs. In this case Bank B will need to undertake certain checks in relation to Party Y as described below as per the banks RBA.

g. 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. Each role as defined by the UCP determines the level of review that a bank will undertake, and therefore the level of compliance related activity will depend on that role.

   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, out of necessity, become involved in the transaction before it is fully completed.

The following table illustrates the different roles of Bank B and the checks which may be needed in respect of Party Y, in addition to the usual checks as defined in Stage 1, 2 and 3 above:

Role of Bank B	**Checks conducted in relation to Party Y where Y is not B's customer**
Advising bank	Name screening of Party Y for Sanctions purposes.
Transferring bank	Name screening of Party Y for sanctions purposes. Payment must only be made to a bank (which has been name screened for sanctions) through an established payment channel. Additional checks on Y may be required using a RBA.
Confirming bank	Name screening of Party Y for sanctions purposes. Payment must only be made to a bank (which has been name screened for sanctions) through an established payment channel. Additional checks on Y may be required using a RBA.
Negotiating or discounting a presentation under DC	Name screening of Party Y Presentation of documents to Bank B has to occur via Party Y's Bank (i.e. no direct presentation of documents by Party Y without appropriate non-customer risk based controls) Payment must only be made to a bank (which has been name screened for sanctions) through an established payment channel. Additional checks on Y may be required using a RBA
Making payment on behalf of Bank A after handling documents	Name screening of Party Y for sanctions purposes. Payment must only be made to a bank, (which has passed name screening for sanctions), through an established payment channel.
Reimbursing bank – will debit bank A's account to settle the claim from the bank which pays Y	Payment must only be made to a bank (which has been name screened for sanctions) through an established payment channel.

h. 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.

i. 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 in accordance with Bank B's RBA.

6.2 **Reviewing:**

a. Reviewing may take place principally at three stages; - i.e. reviewing the DC issued while advising, transferring, confirming, reviewing the documents presented and making the payment. A detailed explanation of potential reviewing activities is set out below:

- **Stage 1: Reviewing the DC received**

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

  - Sanctions and Terrorist lists, which may affect:
    - Directly, any named Party
    - The country in which Party X is located
    - The goods involved
    - The country where the goods are shipped from, any disclosed transhipment points and destination points
    - Names appearing in the DC

  - 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, type and value of these goods appear to make sense

  - The applicant of the DC (Party X) to ensure that:
    - As a result of any screening activity Bank B would not regard them as unacceptably high risk

  Risk indicators and Unusual Activity

  - 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
    - Depending on circumstances, local regulatory and legal requirements, Bank A must file a suspicious activity report to the appropriate Authority and take any additional action as required by local laws and regulations.

- **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 lapse 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

- The extent to which the documents presented comply with the terms and conditions of the DC and that the documents are consistent among themselves and the information contained therein do not conflict
- Whether an unusual payment instruction is given by Party Y
- The screening of all names and parties related to the transaction against current applicable lists.

o 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

o Checking of the received documents against any Risk indicators or scenarios that Bank B has determined to apply in its RBA.

o Depending on circumstances, local regulatory and legal requirements, Bank A must file a suspicious activity report to the appropriate Authority and take any additional action as required by local laws and regulations.

- **Stage 3: Making the payment**

  o When making payment Bank B will review the names in the payment instructions, including the names of any banks involved.

6.3 **Monitoring:**

For Bank B the monitoring opportunities arise from:

a. 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 as per the bank's RBA.
b. Where Party Y is Bank B's customer, the normal procedures for monitoring the account and payment activity.
c. Where Party Y is not Bank B's customer, activity observed from business as usual trade processing.

6.4 **Limitations faced by Bank B:**

a. 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 DCs, 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.

b. 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 RBA related to the precise capacity in which it is acting. This may be limited to reviewing relevant Party names against sanctions or terrorist lists.

7. **Risk Indicators, Pre- and Post-Event:**

a. A DC 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 DC can be issued. The terms of each DC 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 that are Party to the financing and payment arrangements.

b. Since the full execution of each DC 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.
   - Banks around the world, especially those located in developing countries, are at different levels of maturity as far as application of ML, CDD and Sanctions risks and the mitigation thereof (variations in the level of sophistication of FCR systems and processes in banks can be extreme, even within a single country). 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.

c. For Banks involved in processing DCs, 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 DC in accordance with the applicable ICC rules for International Standard Banking Practice.

d. Potentially there are a large number of risk indicators. Against this background it is important to distinguish between:
   - Information which must be validated before transactions are allowed to proceed or complete and which may prevent such completion. (e.g. a terrorist name, sanctioned entity)
   - Information which ought to be used in post event analysis as part of the investigation and suspicious activity reporting process.

e. Banks should look to put into place systems (either manual or automated) to monitor the risk indicators and their customers' business flows and have processes to review and escalate concerns appropriately.

f. Appended below is a list of some of the risk indicators which might become apparent in the handling of a DC transaction. This table does not contain the full range of risk indicators which might apply generally across the customer to bank relationship, but is specifically targeted to cover some of the risk indicators related to the processing of a DC 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. Banks should derive their own set of risk indicators from their risk assessments.

Some Risk Indicators (not exhaustive)

WHAT: Activity or information connected with the DC	WHEN: Pre or post transaction
Deal structures • Beyond capacity and or substance of customer • Improbable goods, origins, quantities, destination • Unusual complexity and or unconventional use of financial products	PRE or POST
Goods • Applicable import or export controls regulations may not be complied with	PRE – as part of on boarding CDD
• Blatant anomalies in value versus quantity • Totally out of line with customer's known business	PRE or POST
Countries and names • On the Sanctions or terrorist list	PRE
Countries • On the Bank's high risk list • Any attempt to disguise or circumvent countries involved in the actual trade	PRE or POST
Payment instructions • Illogical • Last minute changes	PRE or POST
Repayment arrangements • Third parties are funding or part funding the DC value (just in time account credits to the settlement account)	POST
DC patterns • Constantly amended or extended • Routinely cancelled or unutilised	POST
DC Parties • Connected applicant and beneficiary • Applicant documentation controls payment	PRE or POST
Discrepancies in documents (not necessarily grounds for rejection under UCP600) • Goods descriptions differ significantly • Especially invoice v shipping doc • Unexplained third parties	PRE or POST
Discrepancies waived • Advance waivers provided • Absence of required transport documents • Significantly overdrawn DC (tolerance allowed by standard practice)	PRE or POST

Summary of possible controls (as falling within each bank's RBA) described in this guidance on the lifecycle of the DCs

REVIEWING STAGE	WHO OR WHAT IS REVIEWED	AGAINST WHAT	BY WHOM
Account Opening Party X	• Party X	Appropriate due diligence	Bank A
Account Opening Party Y where Party Y is a customer of Bank B	• Party Y	Appropriate due diligence	Bank B
DC Issuing request from Party X	• Party X • Party Y and or other named parties • Names & Countries • Goods type • Ports • DC structure • Risk indicators	Sanctions lists Local applicable export control lists if known AML Checks as per internal procedures.	Bank A
Bank A issues DC to Bank B	• Bank B	Sanctions list	Bank A
Bank B receiving DC from Bank A	• Bank A • Party X • Party Y and or other parties • Names & Countries • Goods type • Ports • DC Structure • Risk indicators	Sanctions lists Local applicable export control lists AML Checks as per internal procedures.	Bank B
DC advising by Bank B to Party Y	• Party Y	1. Appropriate customer risk based controls; 2. Appropriate non-customer risk based controls – (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	• Bank A • Party X • Party Y and other parties • Names & Countries • Goods type • Vessel name • Shipping company or carrier or agent • Ports • DC Structure • Risk indicators	Sanctions lists Local applicable export control lists AML Checks as per internal procedures.	Bank B
Presentation of documents by Bank B to Bank A	• Vessel Name • Shipping company or carrier or agent • New named parties or countries not mentioned in DC • Documents • Goods type • Risk indicators	Sanctions lists AML Checks	Bank A
Payment by Bank A to Bank B	• Names on the payment instruction	Sanctions lists AML Checks	Bank A

Payment by Bank B to Party Y	• Names on the payment instruction	Sanctions lists AML Checks	Bank B

Appendix II: Bills for Collection

1. Introduction

1.1 The Trade Finance Principles Paper sets out the background to Trade Finance as defined in section 1 of the core paper and addresses associated FCRs. 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.

1.2 This appendix provides guidance on the specific application of controls by Banks[35] in the context of Bills for Collection (BCs). It is intended to reflect standard industry practice. In order to illustrate these controls fully, 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.

1.3 The controls fall into the following categories:

a. **Due Diligence:** To be defined in this paper as
   - the risk based process for identifying and knowing the customer;
   - the risk based controls in relation to parties who may not be customers.

   Given the range of meanings, reference will be made as necessary to appropriate risk based checks.

   Each bank's established CDD policies should designate which party to a trade transaction is the customer and therefore subject to the bank's due diligence process. It is not the responsibility of any single bank to perform due diligence on all parties to a trade transaction.

   Banks should have policies and procedures covering CDD, whereby all customers of the bank, including correspondent banks and non-customer Banks, will be subject to the bank's CDD procedures. Such information should be made available to all the areas handling Trade Finance customers and transactions, to enable them to understand expected activity and identify suspicious activity.

b. **Review:** Defined as any process (whether manual or automated) to review relevant information available in a transaction relating to the relevant parties involved, documents presented and instructions received. Certain information can, and should, be reviewed and checked before transactions are allowed to proceed.

   Reviewing activity as described in this paper, equates to document checking where the documents and their contents are checked for conformity. Appropriate FCR checks should be done based on the information in the documents, transaction details and relevant information from the customer CDD profile. References to "review cycle" relate to the customer CDD review process whereby the relationship as a whole is "reviewed" on an agreed cycle, typically a one to three year cycle dependent upon the bank's risk assessment of the customer.

[35] 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

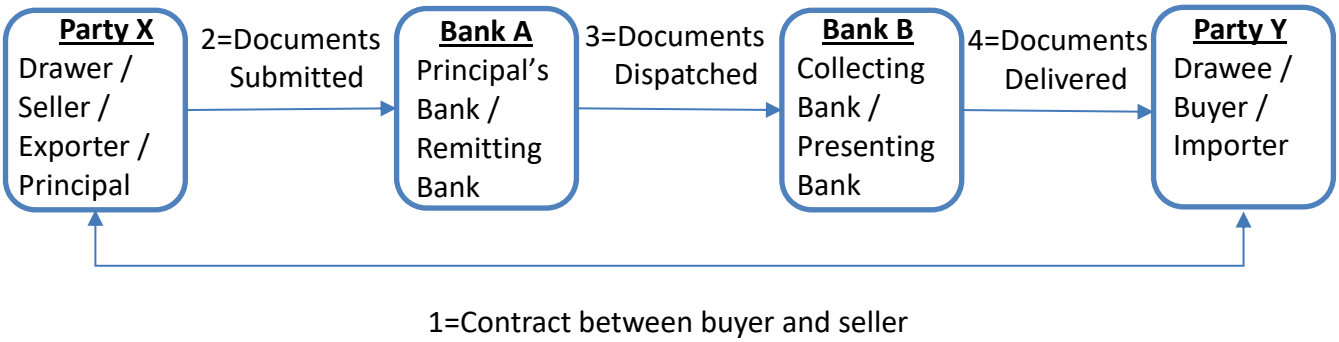
c. **Screening:** Processes, usually automated, whereby lists of names, entities, persons or countries, derived from various official sanctions or prohibited persons lists are used to identify possible fraud, sanctions or other concerns with respect to a relationship or transaction.

d. **Transaction Monitoring:** Defined as any activity to review completed or in progress transactions for the presence of unusual and potentially suspicious features. For Collections, as with DCs, it should be recognised that it is difficult, if not impossible, to introduce any standard patterning techniques in relation to transactional monitoring processes or systems. This is due to the range of variations which are present even in normal trading patterns. The significant presence of paper documents in this type of trade, and the continuing difficulty of the global trade businesses to fully adopt standardised electronic solutions, will continue to see a need for manual input even in transaction monitoring. While the latest technological developments may give rise to the possibility of automation and pattern based recognition systems, these systems are still under development, are unproven and represent investment requirements that will be attainable only to the larger banks. A summary of 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 **Section 4: Glossary of Terms**.

1.4 It is important to note that with BCs the banks typically operate in accordance with ICC Publication No. 522 – Uniform Rules for Collections.[36] 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 DCs (refer to Appendix I).

2.

Simplified Scenario – Bills for Collection (BC)



2.1 As depicted in the diagram, Party X is selling goods to Party Y. Party X is the customer of Bank A, and Party Y may or may not be a customer of Bank B.

2.2 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.

[36] "The Uniform Rules for Collection (1996 Revision), ICC Publication No. 522

2.3 Party X (the seller) instructs Bank A to collect payment in relation to documents drawn on Party Y (the buyer). Bank A selects another 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 subject to:

a. Payment by Party Y to Bank B, or

b. 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

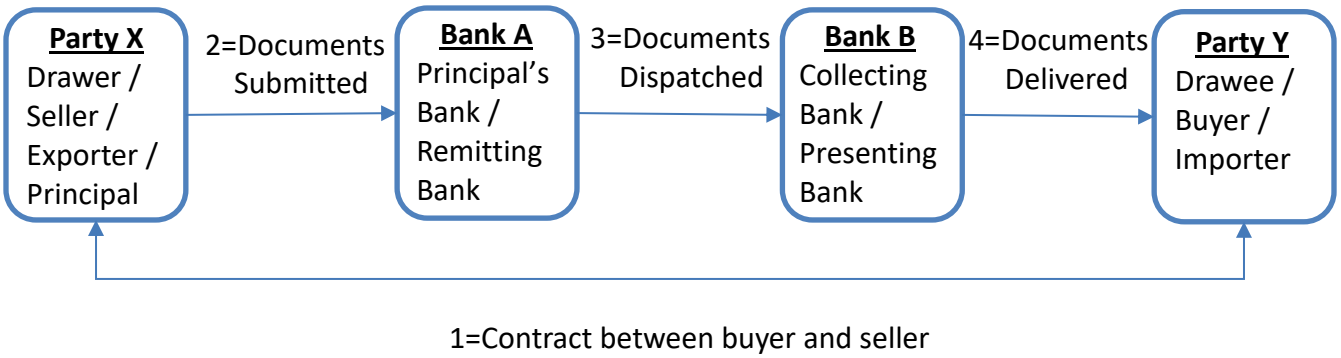
c. Other stipulated terms and conditions

2.4 The presentation terms (collection instructions) 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.

2.5 An overview of the due diligence and reviewing activities is provided in the table at the end of this appendix.

3.

Simplified Scenario – Bills for Collection (BC)

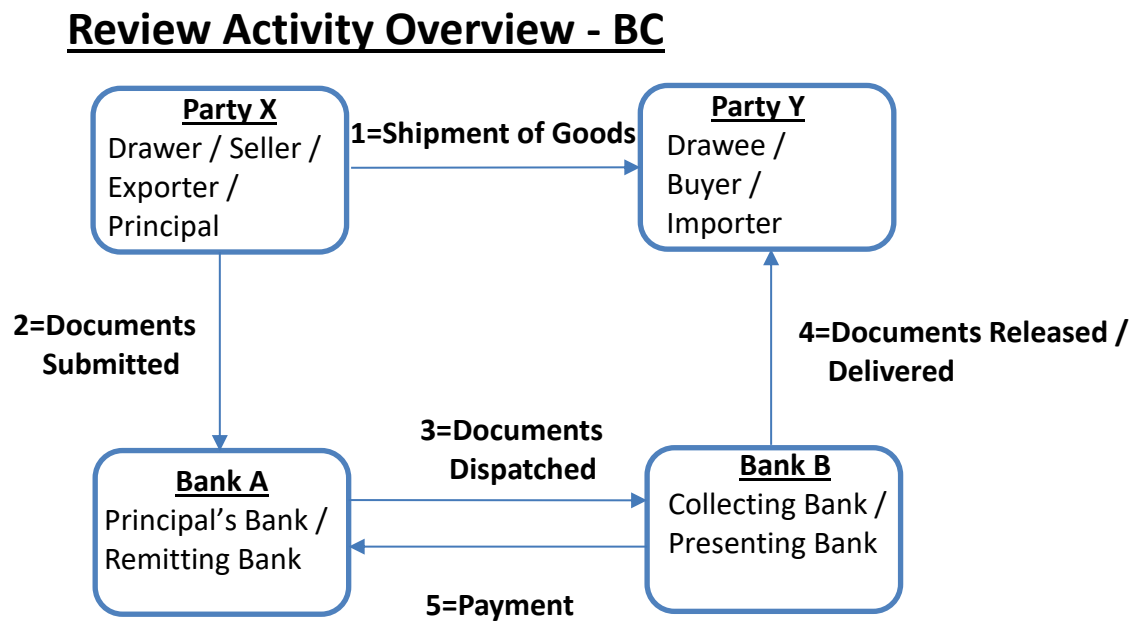


3.1 The banks conduct due diligence, which usually follows the pattern described below:[37]

a. Bank A will conduct due diligence on Party X (when on boarding and during the account CDD review cycle)
b. Bank A should conduct appropriate risk based due diligence on Bank B and at review
c. Bank B should conduct appropriate risk based due diligence on Bank A and at review
d. Bank B will conduct risk based due diligence on Party Y where Party Y is B's customer
e. Bank B will conduct appropriate risk based control checks on Party Y where Party Y is not B's customer

[37] This information is obtained prior to transactional activity and the data is made available to the processing department during the transactional verification process.

4.



4.1 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 made. This reviewing activity will normally follow the pattern described below:

a. Bank A will review the BC application from Party X (before agreeing to send the BC)
b. Bank B will review the BC as received from Bank A (before informing Party Y)
c. Bank B will release the documents to Party Y upon fulfilment by Party Y of the conditions for release of documents as outlined under the BC (see Paragraph 2.3)
d. At sight, or maturity, Bank B will collect payment from Party Y and will transfer the funds received to Bank A for further application to Party X.
e. Bank A and Bank B will screen the payment (or other) instructions which they receive

5. Controls undertaken by Bank A

5.1 **Party X Due Diligence:**

a. Bank A should conduct appropriate due diligence[38] on Party X (who is a customer of Bank A) prior to handling of the original BC. 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 BC handled.

b. This would be available for use by Trade Finance operations for confirmation that each transaction is in accordance with the CDD profile.

[38] Identification, verification screening, KYC (and credit approval)

c. Bank A's due diligence process should include, where BC handling is required, the following questions:
   - 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.)

Additionally, Bank A can be expected to have a RBA to obtaining information on a transactional basis about:
   - 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)

d. Having received the answers to these questions, it may be required to conduct enhanced due diligence.

5.2 **Enhanced Due Diligence (EDD):**

a. An EDD process should be automatically applied, within the normal process of due diligence, 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 (See the FATF 40 Recommendations[39], Section 10 Guideline H). 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

b. 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.

c. Trigger Events:
   There may be trigger events during the on boarding stage or during the ongoing review of a relationship or transaction
   - The nature of business and the anticipated or actual transactions as described and disclosed in the initial due diligence stage or during the relationship may not necessarily suggest a higher risk category. However if, during the course of any transaction, any additional high risk factors become apparent, this may warrant additional or enhanced due diligence.
   - This due diligence may include third parties (i.e. parties not associated with Bank A, intermediaries, or traders using back to back or transferable DCs to unconnected other parties).

5.3 **Bank B Due Diligence (Collecting Bank/Presenting Bank):**

a. Bank A should undertake appropriate due diligence on Bank B, depending on the nature of the relationship between Bank A and Bank B. The due diligence will support an on-going relationship with Bank B which will be subject to a relevant risk based review cycle. Therefore, due diligence on Bank B for any subsequent transactions is not required.

[39] FATF 40 Recommendations (2012), http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html

b. See the Wolfsberg Correspondent Banking Standards[40] and FAQs for guidance with respect to the level of due diligence to be performed in relation to Bank B.

5.4 **Reviewing:**

a. **Stage 1: Reviewing the BC and accompanying documents**

Under URC522, the Bank is not required to review the content of the documents; however for the purpose of combating Financial Crime, Bank A should proceed to the following reviews:

Appropriate reviews should be conducted by Bank A in relation to the BC request and accompanying documents when received from Party X, which could include the following (depending on the documents received):

- Sanctions and 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 goods are shipped from, disclosed transhipment points, and destination points.
  - All other names appearing in the documents

- 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 if:
  - The type and quantity of goods, and value of transactions, (where it is possible to check such details within the RBA of the bank) is consistent with what is known of Party X

- The buyer (Party Y)
  - On the face of it they are the kind of counter-party which is consistent with what is known of Party X's business.

- Risk indicators and Unusual Activity
- 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 to send the BC, but make a record of the circumstances that allowed the transaction to proceed for review purposes
  - Decline the transaction if enquiries do not provide reasonable explanations, and, subject to circumstances and local legal requirements, submit an internal suspicious activity report to the appropriate department that handles FCRs.
  - Depending on circumstances and its RBA Bank A may still decide to submit an internal suspicious activity report to the appropriate department that handles FCRs after the BC was sent out.

[40] Wolfsberg Anti-Money Laundering Principles for Correspondent Banking (2014), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Correspondent-Banking-Principles-2014.pdf

b. **Stage 2: Making the payment**

When making payment, Bank A will screen the names in the payment instructions, including the names of any banks involved.

5.5 **Monitoring:**

a. 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

5.6 **Ongoing Due Diligence by Bank A:**

a. Ongoing review of relationship with Party X on a periodic basis.

6. Controls undertaken by Bank B

6.1 **Due Diligence:**

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

b. Bank B should undertake appropriate due diligence on Bank A. The due diligence may support an on-going 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.

c. If Bank B acts as Collecting Bank, Bank B should have appropriate CDD on Party Y.

d. See the Wolfsberg Correspondent Banking Standards[41] for guidance with respect to the level of due diligence to be performed in relation to Bank A.

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

f. 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 relationship in place between Bank A and Bank B). In this case Bank B will need to undertake certain checks in relation to Party Y as described below.

The following table illustrates the different roles of Bank B and the checks which may be needed in respect of Party Y, in addition to the usual checks as defined in section 6.2 a, Stage 1 below:

Role of Bank B	Checks conducted in relation to Party Y where Y is not B's customer
Collecting bank	Name screening of Party Y and Party X

[41] Wolfsberg Anti-Money Laundering Principles for Correspondent Banking (2014), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Correspondent-Banking-Principles-2014.pdf

	Payment must only be made to Bank A, the Remitting bank (which has been name screened) through an established payment channel. Additional checks on Y and X may be required using a RBA.
Presenting bank	Name screening of Party Y and Party X Payment must only be made to Bank A, the Remitting bank (which has been name screened) through an established payment channel. Additional checks on Y and X may be required using a RBA.

g. 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 in accordance with Bank B's Risk Based policies.

6.2 **Reviewing:**

Reviewing may take place principally at 3 stages, i.e. reviewing the BC instruction, reviewing the documents presented, and making the payment. A detailed explanation of potential reviewing activities is set out below:

a. **Stage 1: Reviewing the BC Instruction/Covering schedule/Documents**

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

- Sanctions and 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 transhipment points and destination points
  - Names appearing in the BC documents

- 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 type and value of these goods appears to make sense

- The Seller of the BC (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

- Decline the transaction if enquiries do not provide reasonable explanations, and, subject to circumstances and local legal requirements, submit an internal suspicious activity report to the appropriate department that handles FCRs.
- Depending on circumstances and its RBA Bank A may still decide to submit an internal suspicious activity report to the appropriate department that handles FCRs after the BC was sent out.

Checking of the received documents against any Risk indicators or scenarios that Bank B has determined to apply in its RBA.

b. **Stage 2: Making the payment**

o When making payment Bank B will review and screen the names in the payment instructions, including the names of any banks involved.

6.3 **Monitoring:**

For Bank B the monitoring opportunities arise from:

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

6.4 **Limitations faced by Bank B:**

a. 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 BCs 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.

b. 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 RBA related to the precise capacity in which it is acting. This may be limited to reviewing relevant Party names appearing in the BC against Sanctions and Terrorist lists.

6.5 **Risk Indicators Pre and Post Event:**

a. In handling BCs banks do not incur independent undertakings, however in BC the checking of the document will be performed against Trade risk indicators scenarios that Bank B has determined to apply through its RBA. 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 DCs. 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.

b. 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 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 3.1 (a) of the Principles Paper)

c. For Banks involved in processing BCs, 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 each other for material differences, that they relate to the transaction described in the covering schedule and the terms and conditions of the BC instructions in accordance with the applicable ICC rules and standard international banking practice.

d. Potentially there are a large number of risk indicators. Against this background it is important to distinguish between:
   - 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)
   - Information which ought to be used in post event analysis as part of the investigation and suspicious activity reporting process.

e. Banks should look to put into place policies, procedures and systems (either manual or automated) to monitor the risk indicators and their customers' business flows and have processes to review and escalate concerns appropriately.

f. Appended below is a list of some of the risk indicators which might become apparent in the handling of a BC transaction. This table does not contain the full range of risk indicators which might apply generally across the customer and bank relationship, but is specifically targeted to cover some of the risk indicators related to the processing of a BC 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 national financial investigation units as part of their formal investigation processes.

Some Risk Indicators (not exhaustive)

WHAT: Activity or information connected with the BC	WHEN: Pre or post transaction
Deal structures • Beyond capacity and or substance of customer • Improbable goods, origins, quantities, destination • Unusual complexity and or unconventional use of financial products	PRE or POST
Goods • Applicable import or export controls regulations may not be complied with	PRE – as part of onboarding CDD
• Blatant anomalies value versus quantity • Totally out of line with customer's known business	PRE or POST

Countries and names • On the Sanctions and or terrorist list	PRE
Countries • On the Bank's high risk list • Any attempt to disguise and or circumvent countries involved in the actual trade	PRE or POST
Payment instructions • Illogical • Last minute changes	PRE or POST
Repayment arrangements • Third parties are funding or part funding the BC value (just in time account credits to the settlement account)	POST
BC Parties • Connected Drawer or Drawee	PRE or POST
Discrepancies in documents • Goods descriptions differ significantly	PRE or POST

Summary of controls described in this guidance on the lifecycle of the BCs

REVIEWING STAGE	WHO OR WHAT IS REVIEWED	AGAINST WHAT	BY WHOM
Account Opening Party X	• Party X	Appropriate due diligence	Bank A
Account Opening Party Y where Party Y is a customer of Bank B	• Party Y	Appropriate due diligence	Bank B
BC handling request from Party X	• Party X • Party Y and other named parties • Names and Countries • Goods type • Ports • Risk indicators • Vessel Name	Sanctions lists Local applicable export control lists if known AML Checks as per internal procedures.	Bank A
Bank A Remits Collection to Bank B	• Bank B	Sanctions Lists	Bank A
Bank B receiving BC from Bank A	• Bank A • Party X • Party Y and other parties • Names and Countries • Goods type • Shipping-company • Ports • Vessel name • Risk indicators	Sanctions lists Local applicable export control lists AML Checks as per internal procedures.	Bank B
BC advising by Bank B to Party Y	• Party Y	1. Appropriate customer risk based controls; 2. Appropriate non-customer risk based controls – (this will vary depending on whether Party Y is a customer of Bank B and the exact capacity of Bank B)	Bank B
Bank B as Presenting Bank	• Bank A • Party X • Party Y and other parties • Names & Countries • Goods type • Ports • Vessel name • Risk indicators	Sanctions lists Local applicable export control lists AML Checks as per internal procedures.	Bank B
Payment by Bank B to Bank A	• Names on the payment instruction	Sanctions lists AML Checks	Bank B
Payment by Bank B to Party X	• Names on the payment instruction	Sanctions lists AML Checks	Bank A

Appendix III: Guarantees and Standby Letters of Credit

1. Introduction

1.1 The Trade Finance Principles Paper sets out the background to Trade Finance as defined in the introduction of Section 1 of the Core paper and addresses associated FCRs. 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.

1.2 This appendix provides guidance on the specific application of controls by banks[42] in the context of Guarantees and Standby Letters of Credit ("SBLC"). It 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.

SBLCs and Guarantees are different from Documentary Credits ("DCs"); while a DC is a *performance-related payment instrument* (i.e. once the seller has performed and presents the required documentation, the DC can be drawn upon and payment made), both Guarantees and SBLCs are instruments generally used to secure a compensation payment to the beneficiary only in the case of *non-performance* (i.e. the SBLC or Guarantee may provide compensation to either (a) to a buyer for the seller's failure to provide the contracted goods or services in accordance with specified timelines or other performance measures, or (b) to a seller where the buyer fails to make regular payment under a sales contract).

Under some circumstances, usually unrelated to the movement of goods or services, SBLC's may function as both a payment instrument and as an assurance of payment.

1.3 SBLCs are distinguishable from Guarantees, as SBLCs usually only require a simple demand for payment along with a statement of default and are subject to either ISP98 or UCP600, while Guarantees usually subject to URDG 758 more often require a simple demand with a statement of the nature of the default or claim. Use of a Guarantee versus an SBLC may also vary based on local law or prevailing business practice.

1.4 Guarantees and SBLCs may be issued in support of the supply of goods or services such as (Performance Bonds, Advance Payment Guarantees, Tender Bonds, Bid Bonds), and those used to secure a purely financial obligation such as (Counter Indemnities, the repayment of credit facilities or the payment of leasing fees). They may be issued in connection with the supply of utilities such as water, power, etc., they are also used in support of bond issues, licences to operate, etc. as part of the contract terms. They may also be issued to support a contract of performance in a third country, different to both the country of the applicant and the beneficiary.

1.5 SBLCs and Guarantees can be used in support of many types of financing or other commercial prospects. It should, therefore, be recognised that most SBLCs and Guarantees issued are not related to Trade Finance activities (i.e. are not related to the movement of goods, import and export).

1.6 The risk control framework for Guarantees and SBLCs is, however to a certain extent, similar to that applicable to DCs, in that when a Guarantee or SBLC is issued, the risk control framework should generally have elements adequate to identify 1) The nature of the counterparty relationship; 2) The reasonableness of the underlying

[42] 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 Guarantees and Standby Letters of Credit.

transaction, when compared with the business operations of the counterparties; and 3) Whether either the underlying activity or the counterparties to the activity are sanctioned by relevant authorities.

1.7 Differences in the application of such a control framework arise; however, as DC-related risk control frameworks typically contemplate payments as the expected result of the business process whereas, in the context of SBLCs and Guarantees, payments would generally be the exception. Risk controls specific to situations where Guarantees and SBLCs are drawn upon or paid should also address sanctions, expected activity and identify potential suspicious activity.

1.8 The controls fall into the following categories:

a. **Due Diligence:** Defined in this paper as:
   - The risk based process for identifying and knowing the customer;
   - The risk based controls in relation to parties who may not be customers.

   Given the range of meanings, reference will be made as necessary to appropriate risk based checks

   Each bank's established CDD policies should designate which party to a trade transaction is the customer and therefore subject to the bank's due diligence process. It is not the responsibility of the bank to perform due diligence on all parties to the trade transaction.

   Banks should have risk based policies and procedures covering CDD, whereby all customers of the bank, which includes correspondent banks, will be subject to the bank's CDD processes and procedures. Due diligence information should be made available to all areas handling Trade Finance customers and transactions, to enable them to understand the customer profile including expected activity and identify suspicious activity.[43]

b. **Review:** Defined as any process (whether manual or automated) to review relevant information available in a transaction relating to the relevant parties involved, documents and data presented, and instructions received. Certain information can, and should, be reviewed and checked before transactions are allowed to proceed.

   Reviewing activity as described in this paper, equates to document checking where the documents and their contents are checked for conformity. Appropriate FCR checks should be done based on the information in the documents and transaction details and relevant information from the customer CDD profile. References to "review cycle" relate to the customer CDD review process whereby the relationship as a whole is "reviewed" on an agreed cycle typically of one to three years dependent upon the bank's risk assessment of the customer.

c. **Screening:** Processes, usually automated, whereby lists of names, entities, persons or countries, derived from various official sanctions or prohibited persons lists are used to identify possible fraud, sanctions or other concerns with respect to a relationship or transaction.

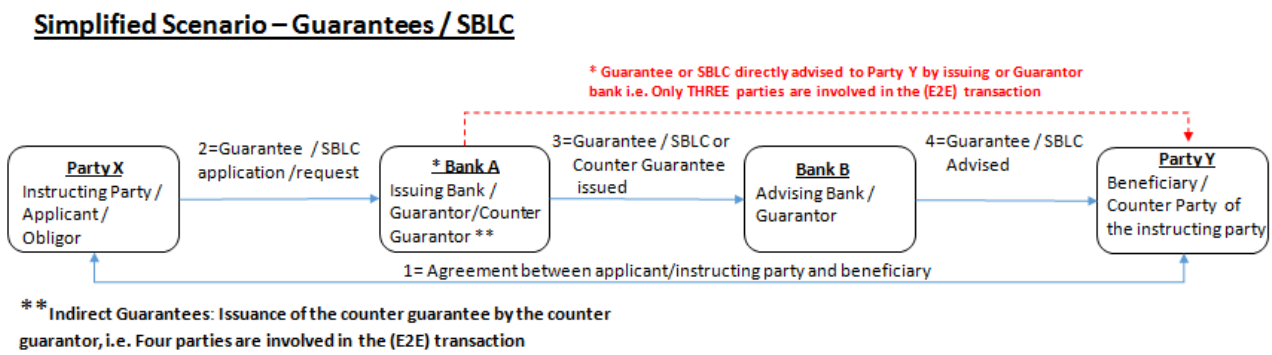
d. **Transaction Monitoring:** Defined as any activity to review completed or in progress transactions for the presence of unusual and potentially suspicious features. For SBLCs and Guarantee transactions, it should

[43] BAFT *Guidance for Identifying Potentially Suspicious Activity in Letters of Credit and Documentary Collections* (2015), https://baft.org/policy/document-library

be recognised that it is difficult, if not impossible, to introduce any standard patterning techniques in relation to transactional monitoring processes or systems. This is due to the range of variations which are present when SBLCs and Guarantees are used in support of construction, design and supply contracts where beneficiaries, nature and size of the transactions will vary significantly, whilst other transactions will be exactly, if not the same and to the same counter parties (lease or rental guarantees for example). While the latest technological developments may give rise to the possibility of automation and pattern based recognition systems, these systems are still under development, are unproven and represent investment requirements that will be attainable only to the larger banks. Controls which apply (i.e. Due Diligence, Reviewing, Screening and Monitoring) are largely the same as defined in the Appendix relating to DCs. A summary of 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 **Section 4: Glossary of Terms**.

1.9 It is important to note that with SBLCs the banks operate in accordance with ICC Publication No. 600 – Uniform Customs and Practice for Documentary Credits, or Publication 590 – International Standby Practices ISP98. Guarantees may follow the ICC Uniform Rules for Demand Guarantees ICC Publication 758 or otherwise simply be subject to a national law and regulations. The extent of reviewing activity which banks carry out is determined by their responsibilities as defined within these internationally accepted rules. ISP98 and URDG758 are different from UCP600. SBLCs are often issued subject to the UCP, which was designed primarily for DCs, and as a result exclusions and variations of its rules are often used.

2. Simplified Scenario



2.1 As depicted in the diagram, Party X is supplying goods or services to one of their buyers, Party Y. Party X is the customer of Bank A, and Party Y may or may not be a customer of Bank B.

2.2 Prior to shipping the goods, Party Y wants to know that they will be paid damages should the shipment not be made, so Party Y requests that a SBLC or guarantee be issued in its favour and advised through Party Y's bank, Bank B, with payment to be made only against the receipt of stipulated documents, related to the non-shipment of goods, by Party X's Bank, Bank A.

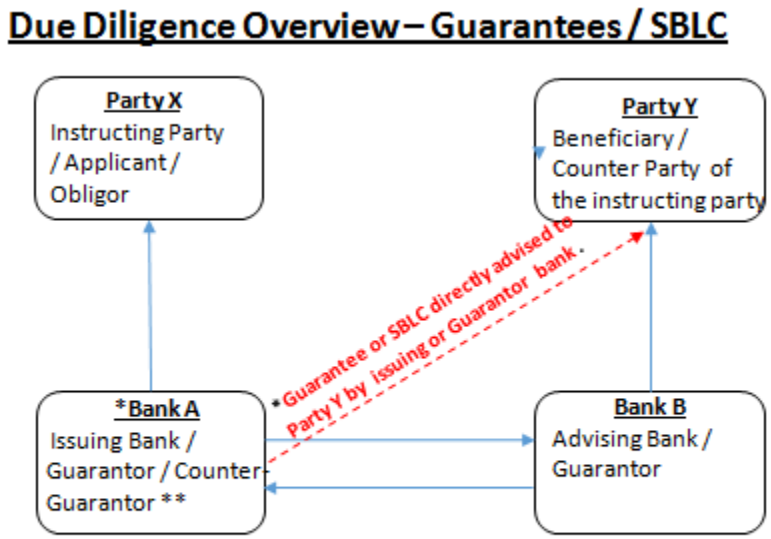
2.3 Party X instructs Bank A to issue a SBLC in favour of the buyer, Party Y.

2.4 Bank A selects Bank B (its correspondent bank or Party Y's nominated bank) to advise the SBLC or guarantee to Party Y locally, often in another country. After the presentation of claim documents by Party Y through Bank B, and having found the claim documents to be in order by Bank A, Bank A will pay under the SBLC.

2.5 In the second simplified scenario, the guarantee or SBLC is delivered by Bank A directly to Party Y. Therefore Bank A will only carry out the appropriate due diligence on Party X. Bank A will conduct appropriate risk based control checks on Party Y where Party Y is not A's customer

2.6 An overview of the due diligence and reviewing activities is provided in the tables at section 3 of this appendix.

3. Due Diligence Overview



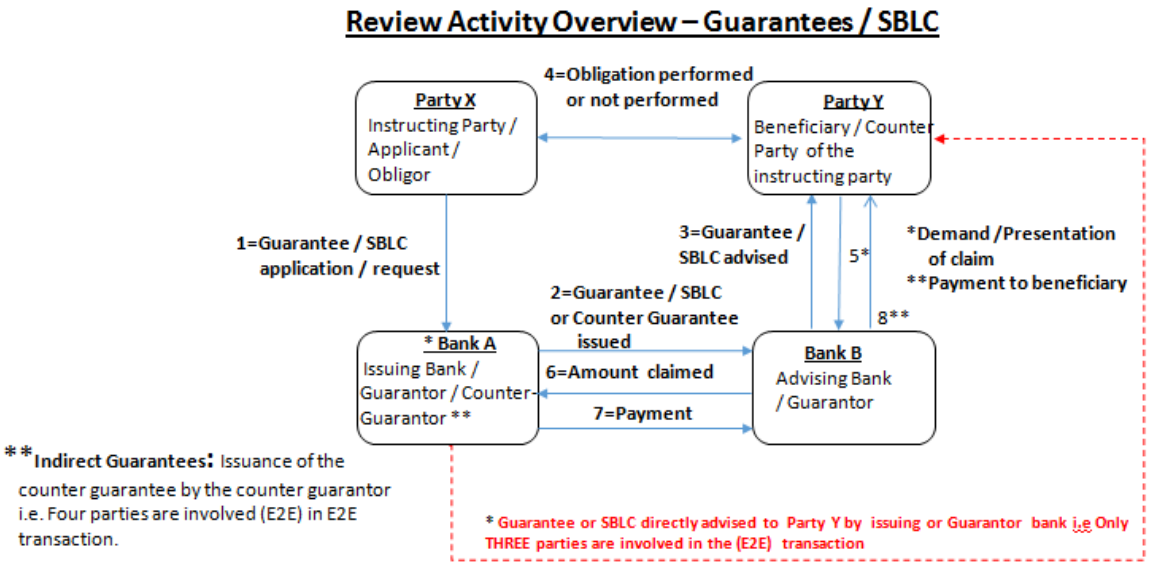
**Indirect Guarantees: Issuance of the counter guarantee by the counter guarantor i.e. Four parties are involved in the (E2E) transaction

3.1 The banks conduct due diligence which usually follows the pattern described below during onboarding:[44]

a. Bank A will conduct due diligence on Party X (when on boarding and during the account CDD review cycle)
b. Bank A should conduct appropriate risk based due diligence on Bank B and at CDD review
c. Bank B should conduct appropriate risk based due diligence on Bank A and at CDD review
d. Bank B will conduct risk based due diligence on Party Y where Party Y is B's customer
e. Bank B will conduct appropriate risk based control checks on Party Y where Party Y is not B's customer
f. In the second simplified scenario, the guarantee or SBLC is delivered by Bank A directly to Party Y. Therefore Bank A will only carry out the appropriate due diligence on Party X. Bank A will conduct appropriate risk based control checks on Party Y where Party Y is not A's customer

[44] This information is obtained prior to transactional activity and the data is made available to the processing department during the transactional verification process.

4. Reviewing Activity Overview



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

a. Bank A will review the SBLC or Guarantee application from Party X (before agreeing to issue SBLC or Guarantee)
b. Bank B will review the SBLC or Guarantee as issued when received from Bank A (before agreeing to advise it)
c. Bank B may review the claim documents presented by Party Y (when accepting them under the SBLC or Guarantee from Party Y) applying a RBA depending upon its precise role.
d. Bank A will review the claim documents presented by Bank B (before paying B - who will in turn pay Party Y)
e. Bank A and Bank B will review the payment (or other) instructions which they receive
f. In the second scenario Bank A will review the claim documents presented by Party Y before paying Party Y via the bank nominated by Party Y to receive payment.

5. Controls undertaken by Bank A

5.1 **Party X Due Diligence:** Bank A should conduct appropriate due diligence[45] on Party X (who is a customer of Bank A) prior to issuance of the original guarantee or SBLC. 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 SBLC applied for. In the second simplified scenario, the guarantee or SBLC is delivered by Bank A directly to Party Y. Bank A will only carry out the appropriate due diligence on Party X. Bank A will conduct appropriate risk based control checks on Party Y where Party Y is not A's customer

[45] Identification, verification screening, KYC (and credit approval)

a. This would be available for use by Trade Finance operations and or guarantees operations for confirmation that each transaction is in accordance with the CDD profile.

b. Bank A's due diligence process should include, where SBLC or guarantee facilities are required, the following questions:
   - The countries in relation to which Party X trades
   - The goods or services traded
   - The type and nature of parties with whom Party X does business (e.g. customers, suppliers, etc.)

Additionally, Bank A can be expected to have a RBA to obtaining information on a transactional basis about:
   - The role and location of agents and other third parties used by Party X in relation to the transaction (only where this information is provided by Party X) and these checks will primarily be related to sanctions screening.

c. Having received the answers to these questions, it may be required to conduct enhanced due diligence in accordance with the FI's procedures.

5.2 **Enhanced Due Diligence:**

a. An enhanced due diligence process, in line with a bank's RBA, should be applied, within the normal process of due diligence, where Party X falls into a higher risk category, or where the nature of their transaction, as disclosed during the standard due diligence process, suggests that enhanced due diligence would be prudent (See the FATF 40 Recommendations[46], Section 10 Guideline H). 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 and or service provided
   - The type and nature of principal parties with whom Party X does business. This does not imply that a counterparty CDD is required

b. 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.

5.3 **Bank B Due Diligence:**

a. Bank A should undertake appropriate due diligence on Bank B, depending on the nature of the relationship between Bank A and Bank B (i.e. Correspondent or Network Bank). The due diligence will support an on-going relationship with Bank B which will be subject to a relevant risk based review cycle. Therefore, due diligence on Bank B for any subsequent transactions is not required.

b. See the Wolfsberg Correspondent Banking Standards[47] and FAQs for guidance with respect to the level of due diligence to be performed in relation to Bank B.

5.4 **Reviewing:**

[46] FATF 40 Recommendations (2012), http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html

[47] Wolfsberg Anti-Money Laundering Principles for Correspondent Banking (2014), http://www.wolfsberg-principles.com/pdf/standards/Wolfsberg-Correspondent-Banking-Principles-2014.pdf

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

   1. Receiving the initial SBLC or guarantee application and subsequent amendment applications from Party X
   2. Only in the event of a claim being made, receiving and checking documents presented by Party Y through Bank B
   3. Making payment

b. In practice, once a SBLC or guarantee has been issued, Bank A has an obligation to complete the transaction. Only if subsequent reviewing activity showed a "positive match" of applicable names in the transactions with the names on Sanctions and Terrorist lists, would Bank A be in a position to stop the transaction. Depending on the local legislation there may be circumstances where fraud would allow Bank A to refuse payment under other circumstances (non-sanctions). This would be determined on a case by case basis in conjunction with the FIs Legal team.

c. When the claim is presented to the guaranteeing bank, either Bank A or Bank B, the claim and supporting documents, if any, will be examined to ensure compliance with the terms of the SBLC or guarantee and that it is in accordance with the UCP, ISP 98 or URDG758 and international banking standards[48] as applicable. Depending on the bank's RBA, this review does not need to involve a detailed examination of all the information in the claim.

   Stage 1: Reviewing the SBLC or Guarantee request or application
   For guidance in respect of what is reviewed, by when and by who in a SBLC or guarantee transaction see the table under "Summary of controls described in this guidance on SBLCs and Guarantees" at the end of this appendix.

   Stage 2: Making the payment
   When making payment Bank A will screen the names in the payment instructions, including the names of any banks involved

5.5 **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

5.6 **Ongoing Due Diligence by Bank A:**

a. Bank A will rely heavily on the initial and ongoing 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.

b. There should be ongoing reviews of the relationship on a periodic basis.

[48] The relevant ICC Rules for DCs are "The Uniform Customs and Practice ISP 98, URDG 758

6. Controls undertaken by Bank B (only if advising or counter guaranteeing)

6.1 The due diligence, reviewing, and monitoring undertaken by Bank B will follow a similar pattern to that set out in the Appendix on DCs.

6.2 Any differences in relation to Guarantees and SBLCs may arise as a result of the following:

a. Any reference to goods may not apply.
b. The likelihood of any claim for payment is much reduced.
c. The legal jurisdictions which apply are more likely to be specified.

7. Risk Indicators, Pre and Post Event

7.1 SBLCs or Guarantees are independent undertakings issued by a bank on behalf of its customer to support a business or financial transaction between the bank's customer (the applicant) and the counterparty (the beneficiary). Contract terms will be agreed between applicant and beneficiary. Details of the required SBLC or Guarantee are then communicated by the applicant to his bank so that the SBLC or Guarantee can be issued. The terms of each SBLC or Guarantee reflect a unique combination of factors involving the specific nature of the underlying 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.

7.2 While the full execution of each SBLC or Guarantee transaction is a process involving a number of parties, with full information available to the commercial parties and the issuer, it is rare for the advising, reissuing, counter guaranteeing Banks to have the same level of detail about the transaction. Furthermore it is relevant to note that:

a. Different Banks have varying degrees of systems capabilities which will lead to industry wide differences in their reviewing capabilities.
b. Commercial practices and industry standards determine finite timescales in which to act.

7.3 For Banks involved in processing SBLCs and Guarantees, the knowledge and experience of their operations staff must serve as the first and best line of defence against criminal abuses of these products and services. Reviewing SBLC or Guarantee claims is a mostly manual process, requiring that the claim and any supporting documents that may be presented for payment are compared against the terms and conditions of the SBLC or Guarantee and, where applicable, any ICC rules and international standard banking practice.

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

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

7.5 Appended below is a list of some of the risk indicators which might become apparent in the handling of an SBLC or Guarantee transaction. This table does not contain the full range of risk indicators which might apply across the customer and bank relationship, but is specifically targeted to cover some of the risk indicators

related to the processing of an SBLC or Guarantee 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. FIs will determine their own set of risk indicators based upon their policies and risk appetite.

Some Risk Indicators

WHAT: Activity or information connected with the SBLC/Guarantee	WHEN: Pre or post transaction
Deal structures • Beyond capacity and or substance of customer • Unusual complexity and or unconventional use of financial products	PRE or POST
Goods (if any) • Applicable import or export controls regulations may not be complied with • Totally out of line with customers known business	PRE or POST
Countries and names • On the sanctions and terrorist list	PRE
Countries • On the Bank's high risk list • Any attempt to disguise and or circumvent countries involved in the actual trade	PRE or POST
Claims and Payment instructions • Last minute changes to payment instructions • Claims made within a short time after issuance • Continuous claims under various guarantee instruments. • Claim pressure tactics	PRE or POST

Summary of controls described in this guidance on SBLCs/Guarantees

REVIEWING STAGE	WHO OR WHAT IS REVIEWED	AGAINST WHAT	BY WHOM
Account Opening Party X Account opening Party Y where Party Y is a customer of Bank B	• Party X • Party Y	Appropriate due diligence	Bank A Bank B
SBLC or Guarantee Issuing request from Party X	• Party X • Party Y and other principal parties • Names and Countries • Goods type (if any) • AML Checks • Ports • SBLC or Guarantee structure • Risk indicators	Sanctions lists Local applicable export control lists if known AML Checks as per internal procedures.	Bank A
Bank A delivers SBLC or Guarantee to Party Y	• Party Y	Sanctions lists Appropriate Risk Based control checks.	Bank A
Bank A issues SBLC or Guarantee to Bank B	• Bank B	Appropriate due diligence	Bank A
Bank B receiving SBLC or Guarantee from Bank A	• Bank A • Party X • Party Y and other parties • Names and Countries • Goods type (if any) • Ports • SBLC or Guarantee structure • Risk indicators	Appropriate due diligence Sanctions lists Local applicable export control lists if known AML Checks as per internal procedures.	Bank B
SBLC or Guarantee advising by Bank B to Party Y	• Party Y	Appropriate 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 claim documents by Party Y to Bank B or Bank A	• New principal parties or countries not mentioned in SBLC/Guarantee	Sanctions lists AML checks	Bank B or Bank A if presentation is direct
Presentation of claim documents by Bank B to Bank A	• New principal parties or countries not mentioned in SBLC/Guarantee	Sanctions lists AML checks	Bank A
Payment by Bank A to Bank B or to Party Y's bank	• Names on the payment instruction	Sanctions lists AML checks	Bank A
Payment by Bank B to Party Y	• Names on the payment instruction	Sanctions lists AML checks	Bank B

8. Counter Guarantees and Counter Standby Letters of Credit.

For AML purposes counter guarantees and SBLCs are treated in the same way as if they are an original or new issuance.

The reissuing bank for a SBLC or the Bank receiving the counter guarantee and issuing its own guarantee locally treats the original issuing bank as the applicant (instructing party) and full CDD is required on them.

As a result, the above procedures apply to the counter guarantee or SBLC.

Appendix IV: Open Account

1.1 The Trade Finance Principles Paper sets out the background to Trade Finance and addresses associated FCRs. 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.

1.2 This appendix provides guidance on the specific application of controls by Banks[49] in the context of Open Account trade transactions.

1.3 Open Account Trade involves the movement of goods or services between two companies, either domestically or internationally, based on mutual trust in which the supplier extends payment and or credit terms. Third-party intermediation to provide processing services or performance risk mitigation or payment financing is not deemed to be required as part of the transaction because of the relationship between the two parties. Many corporations view Open Account Trade as the least expensive way to handle trade-related payments, as it does not incur the costs involved with bank-provided financing or performance risk mitigation services.

1.4 In a typical Open Account transaction, the seller and the buyer contract for the delivery of stated goods from the seller to a place designated by the buyer. The type of contract used for the transaction will depend on the relationship between the buyer and seller; in most consumer good transactions, the standard contract of the buyer's group will apply, although this is not always the case depending on the relationship as the seller could be the larger party and therefore their standard contract of sale will apply, e.g. a multinational manufacturer of refrigerators sells to a small end user. As part of the contracting process, the two parties will generally agree on the terms and method of payment.

1.5 Participants to an Open Account Trade transaction do not look to banks to provide financing related to each specific purchase, and generally finance the transaction out of their own cash flow or through other arrangements. Banks will likely be indirectly involved in the financing of the trade transaction through bank-provided overdraft facilities, revolving lines of credit, post shipment or inventory financing, but will not have information as to the specifics of the trade transaction as is the case in documentary trade.

1.6 For the most part Banks are not involved in an Open Account trade transaction until a clean payment is made at the end (which could be after the goods have been delivered). The seller and buyer will generally not provide the banks handling the Open Account payment with supporting documentation; in the majority of cases, banks will have little inherent opportunity, need, or cause to understand the nature of the underlying trade transaction, or to review any trade-related documentation (e.g., contracts, invoices, shipping documents).

1.7 Banks involved in handling a payment related to an Open Account trade transaction generally do so in one (or both) of two capacities:

a. The seller or buyer is their commercial customer, in which case they are debiting or crediting the account of a customer for which they would be expected to have conducted a certain amount of existing due diligence; and, or

[49] 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 Open Account trade

b. The seller or buyer is the commercial customer of the bank's correspondent banking customer, in which case the bank would not necessarily have any general knowledge about the expected behaviour of their correspondent's customers.[50]

[50]Please refer to the Wolfsberg AML Principles for Correspondent Banking (2014), http://wolfsberg-principles.com/corresp-banking.html