

Money Laundering

Black Market Peso Exchange: An International Scheme

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FRAUD
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Throughout the world, companies are falling victim to the Black Market Peso Exchange. Your organization might be at risk. Here's how you can protect it.

Authorities in Central America, acting at the request of the U.S. Customs Service, seized a luxury automobile manufactured by a well-known Fortune 500 company. The vehicle's final destination was South America, the purchaser a wealthy South American doctor with an exemplary career record. Then the unthinkable happened: U.S. Customs agents froze \$200,000 of the automakers' bank account. Law enforcement officials claimed they had reason to believe the manufacturer had accepted drug proceeds in four separate third-party wire transfers, at \$50,000 each, from four bank accounts. As it turned out, the doctor had discovered a discounted purchasing option: he unwittingly paid for the vehicle with local currency for only 80 percent of the retail price through a local broker. Shockingly, the remitters of the payments actually had no business relationship with the purchaser of the automobile, so the doctor wasn't linked by the authorities to the wire transfers. To the company's misfortune, banking regulations and controls failed to protect them. The car manufacturer is fighting the seizure in court. Regardless of whether the money is found to be related to drug proceeds, the company has been targeted by the Black Market Peso Exchange (BMPE), and will likely pay the consequences.

MONEY LAUNDERING

Investopedia Dictionary defines money laundering as "the process of creating the appearance that large amounts of money obtained from serious crimes, such as drug trafficking or terrorist activity, originated from a legitimate source."

According to the International Monetary Fund (IMF), money laundering transactions are almost beyond imagination – 2 percent to 5 percent of global Gross Domestic Product.

The 1970 Bank Secrecy Act was the first effort to detect and prevent money laundering in the United States but banks widely ignored this law during the early 1980s. A PBS Frontline special, "The Black Peso Money Laundering Systems," produced by Oriana Zill and Lowell Bergman, brought the scheme to public attention. According to Mike McDonald, an interviewee in the documentary and a 1980s South Florida IRS agent, "Drug traffickers were smuggling

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cash out of Miami in the '80s and dumping it into banks. Twelve specific individuals were depositing \$250 million or more annually into non-interest bearing checking accounts, filing few, if any, Currency Transaction Reports.”

And now the United States is using the USA PATRIOT Act of 2001 to crack down on money launderers. However, drug traffickers are seeking novel and ingenious ways to beat the system; they need their local currency to pay coca producers, fund smuggling, and purchase posh property and automobiles.

BPME: METHOD OF CHOICE

Drug traffickers have adopted the BPME as their primary means of money laundering.

“The most common method of trade-based money laundering in the Western Hemisphere is the Black Market Peso Exchange,” according to the 2005 U.S. Money Laundering Threat Assessment, published by the U.S. government. Juan Carlos Zarate, assistant secretary of the Terrorist Financing and Financial Crimes Unit in the U.S. Department of Treasury, appeared before the House Financial Services Committee Subcommittee on Oversight and Investigations on Feb. 16, 2005, and said “the BMPE emerged in the 1980s as a sophisticated alternative to laundering funds through the United States banking system, and while used primarily in South America and the Caribbean, it is most often associated with laundering Colombian drug profits.”

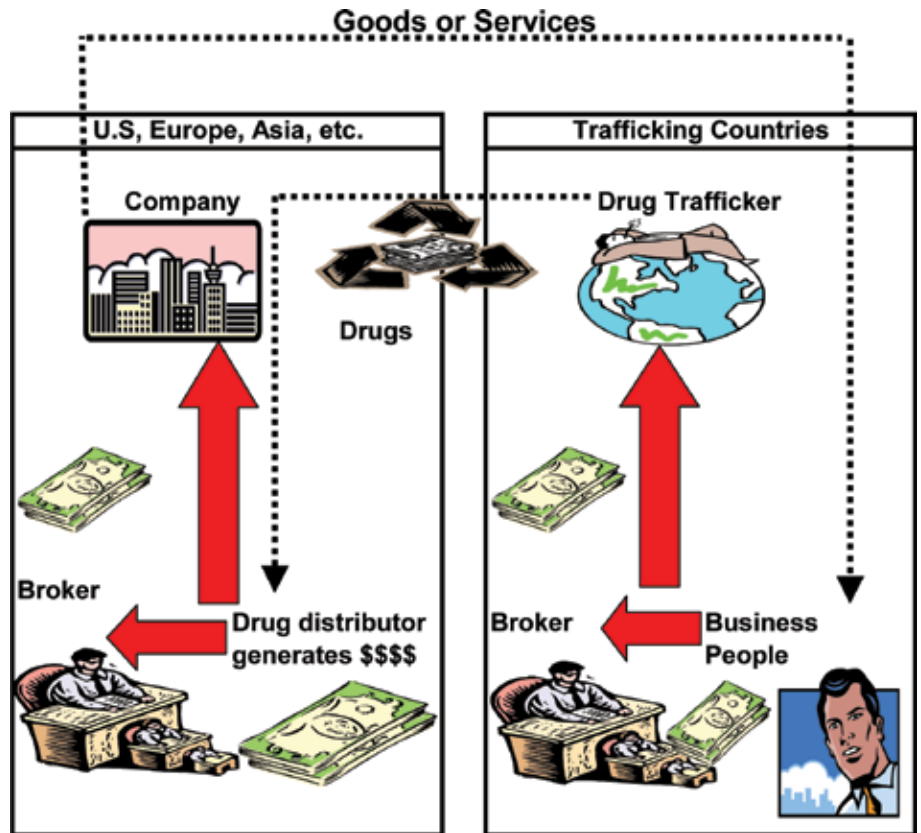
Drug traffickers actually borrowed the BMPE system from crooks smuggling import goods into Colombia who invented it when Colombia began requiring import permits and proof of payment of Colombian duties and taxes to access U.S. dollars through Colombian banking institutions.

(Normally law-abiding ex-pat Colombian businesspeople use the system to hide Colombian purchases from criminals who would like to use the information in the Colombian banking system to target them and their families for extortions, theft, and kidnapping.)

Regrettably, the system isn’t publicized or widely understood outside the federal drug money laundering investigators’ and money launderers’ worlds. Today’s global trade requires everyone in the business community to be educated about the BMPE.

HOW BMPE WORKS

Trade-based money laundering encompasses a variety of schemes including manipulating trade documents to under- or over-pay for imports and exports and the purchase of gems and precious metals. (See the illustration above.)



The process that transforms drug profits into a chief financial officer’s worst nightmare is complex. Drug traffickers first smuggle drugs into a consuming country (such as the United States, Europe, Asia, etc.). After the drugs are sold, the “tainted” proceeds need to be converted into the drug trafficker’s home currency and laundered to conceal that the source was illegal drug sales. Drug traffickers then use intermediaries or brokers to convert and launder drug proceeds into their home currency because they can’t use the banking system or fly drug proceeds to their residence due to increased airport and seaport law enforcement.

The drug trafficker and the broker negotiate an exchange rate to sell the currency for pesos, generally at a discount of around 20 percent to 50 percent from the official government exchange rate. So the broker will deliver to the trafficker approximately between 50 percent and 80 percent of the actual amount earned in pesos at the end of the black market peso exchange cycle without physically moving funds from one country to the other.

For example, if a drug trafficker has illicitly earned US\$100,000, and there’s a C\$2,000 to US\$1 exchange rate, an official exchange would purchase C\$200,000,000. But because the drug trafficker must keep only a portion of the amount to make the illicit exchange, he agrees to accept 70 percent or C\$140,000,000. The broker will keep any exchange rate differential. After the exchange rate is negotiated, the brokers in the

MONEY LAUNDERING

United States receive the drug proceeds and deposit the dollars into U.S. financial institutions through different persons, usually in amounts of less than \$10,000, to avoid suspicion and detection under money laundering statutes. There is now US\$100,000 in the U.S. banking system.

At the same time, the brokers will sell the dollars in the United States for local pesos to South American businessmen through their local contacts at a discounted exchange rate. The dollars are sold for 80 percent to 90 percent of official exchange rates. This means that businessmen can acquire more goods for resale. If, again, there's a C\$2,000 to US\$1 exchange rate, an official exchange would purchase US\$100,000 with C\$200,000,000. The businessman will pay, in effect, only about C\$160,000,000 for US\$100,000 of goods and still would have C\$40,000,000 available to purchase additional dollars.

The dollars placed and layered into the banking system are then used to pay for U.S. export goods acquired by South American businessmen. The brokers send the money via wire transfer or money order from multiple bank accounts to U.S. companies that manufacture or resell cigarettes, liquor, clothing, electronics, appliances, automobiles, computers, or other goods. The discounted rate is a powerful incentive.

In the example, goods costing US\$100,000 are purchased. Note that the ultimate purchaser of the goods didn't pay for them. The payment came from the broker's multiple and scattered accounts. The seller subsequently ships the goods to South America.

After the South American businesspeople receive the goods, they pay the local broker for the agreed peso amount used to pay for the imported goods. The broker can then take his commission plus any agreed exchange rate differential and deliver the remaining drug proceeds to the drug trafficker in the "integration stage" of the scheme. In the example, the broker receives C\$160,000,000 from the businessmen and pays C\$140,000,000 to the drug trafficker, a handsome profit of C\$20,000,000 or US\$10,000, and might receive commissions

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from the businessman as well.

The purchase of the goods might be perfectly legal. The purchase of pesos at a discounted rate might be legal. But the money used to purchase the goods, received by the broker and ultimately delivered to the drug trafficker, is tainted because it's derived from the illegal activity of drug trafficking. Thus, those funds and any goods purchased with those funds might be subject to seizure.

In August of 2000, Panamanian officials, acting at the request of the U.S. Customs, seized a \$1.5 million Bell model 407 helicopter belonging to Victor Carranza, a Colombian national linked to drug trafficking and right-wing groups. U.S. Customs alleged the helicopter had been purchased with proceeds from a massive Colombian cocaine and heroin operation. The manufacturer of the aircraft denied knowing that drug profits were the source of the payments, deposited in 31 separate wire transfers from unrelated individuals. Five of the deposits were made by undercover U.S. Customs agents who infiltrated the drug organization. The wire transfers were later found to have no link to the helicopter's purchaser. The covert customs investigation resulted in 34 U.S. indictments, and the seizure of 1,160 pounds of cocaine and \$4.5 million in cash. Sixty-five accounts were frozen, including Bell's. (Source: Washington Post, Aug. 29, 2001 "U.S., Colombia to Confront Lucrative 'Peso Exchange,'" by Karen DeYoung)

PROTECTING YOUR COMPANY

Here are some suggestions for protecting your company and tips for a timely detection of a BMPE international trade scheme:

Employee education – Educate employees, especially in sales, accounts receivable, and internal auditing. Require "know-your-customer" policies (similar to those in financial institutions). Instruct them to find out and document the legitimacy of customers, resellers, and distributors. Pay special attention to the existence of shell companies. Explain to employees how money laundering works and provide them with a hotline to report suspicious activity.

Customer payment policies and procedures – Establish adequate customer payment restriction policies, which quickly alert management of payments by third parties, wire transfers, money orders, or other transactions that could be associated with BMPE. Institute procedures that prohibit multiple cash, money orders, traveler checks, foreign bank drafts, or wire transfers from third parties unrelated to the entity purchasing the goods or services. An exception to these procedures is an authorized financing company.

Awareness of high-risk individuals or companies – Educate resellers and distributors and establish procedures to prevent the sale of goods to high-risk individuals or companies. Also instruct them of payment restriction policies. Pay close attention to resellers and distributors (especially in Florida because it's close to South America). Note individual consumers making large

purchases, which might not be viewed as personal use or consumption (such as an individual purchasing 100 computers).

Due diligence – Perform due diligence checks on customer credit history and business infrastructure. If practical, visit their headquarters and warehousing facilities.

Protect your company internally – Don't rely on banks and financial institutions to conduct anti-money laundering procedures on behalf of the company. After the terrorist attacks of 9/11, President Bush signed into law the USA PATRIOT Act, which included provisions designed to prevent money laundering for funding of terrorist acts. However, the act was designed mainly to address financial institutions' compliance. Even IRS Form 8300 (U.S.C. 6050I and 31 CFR 103.30), requiring companies and financial institutions to report receipts in excess of \$10,000 in cash or cash equivalents, isn't effective because wire transfers aren't considered cash or cash equivalents.

WHAT TO DO IF YOU'RE ACCUSED

If found guilty of accepting BMPE payments, a company might risk seizure of the money, forfeiture of the goods, fines, loss of export licenses, and even criminal prosecution.

In 1995, Phillip Morris' former distributor in South America was indicted for laundering \$40 million in black market pesos. Phillip Morris ended its relationship with the defendants and denied any knowledge that BMPE was used to purchase their goods. Five years later, Phillip Morris was sued by Colombian tax collectors accusing the company of being involved in cigarette smuggling and the laundering of drug money. Without admitting wrongdoing, the company signed an agreement with Colombian authorities to prevent its products from entering the black market or being used in money laundering. (Source: PBS Frontline. "U.S. Business & Money Laundering," produced by Oriana Zill and Lowell Bergman)

When accused of BMPE, a company can assemble an expert team of lawyers, fraud examiners, investigators, and forensic accountants to investigate, document, and potentially litigate the case. The investigations are complex and might require specific experience, industry knowledge, and an understanding of international trade operations.

These days, it's not uncommon for organizations to be erroneously charged with accepting BMPE payments when their inventory was funded through a legitimate financing company. Companies in the international trade business should be aware of their exposure to the BMPE especially when conducting business with high-risk countries in Latin America. 🔍

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