

AML ALERT: Mirror Trading Behaviours, Red Flags and Vulnerabilities

Extract from NCA Amber Alert – August 2020 (Reference 0611-NECC)

Overview

The mirror trading activity which came to public attention in 2016, in which funds were transferred from Russia to Europe in an opaque and highly suspicious manner, elevated awareness of money laundering risks in capital markets.

Mirror trading is not the only mechanism through which capital markets can be exploited to launder illicit funds, however many linked behaviours and identifiers are applicable to other illicit attempts to exploit similar vulnerabilities.

Consequently, a greater understanding of mirror trading within the framework of broader financial market vulnerabilities is valuable in identifying and mitigating money laundering across the sector.

Mirror Trading Typology

Mirror trading as a trading strategy, as in replicating the activity of a successful trader, may be distinct from mirror trading as a specific money laundering typology.

An understanding of recently publicised mirror trading activity, and the typology underpinning it, provides a basis for a further explanation of the vulnerabilities in financial markets that can be exploited for money laundering purposes.

Further information is available at:

- FCA [Thematic Review](#): “Understanding the Money Laundering Risks in the Capital Markets”, 10 June 2019
- FCA [Final Notice](#) on Deutsche Bank AG, 30 January 2017

Mirror trading is a way significant funds can be transferred from one jurisdiction to another, or from one currency to another, involving the transfer of the underlying value of the securities out of a high-risk jurisdiction.

As the trading of securities is not subject to the same procedures as cross-border money transfers, the practice is potentially used to overcome currency controls, evade sanctions, or launder the proceeds of crime without detection.

A simplified step-by-step example of the mirror trading typology is outlined below:

- An individual or entity has funds in the Russian Federation which they wish to move overseas. They transfer roubles to an organised crime group (OCG) in the Russian Federation which provides a service for moving funds abroad.
- The Russian OCG uses the roubles to purchase securities from a Russian brokerage. The brokerage may be complicit in the scheme or owned by the OCG.
- The Russian brokerage then buys securities from a financial institution in Russia where the price is agreed over-the-counter (OTC). This was often undertaken at the Russian office of a large international bank and the securities are typically highly liquid blue chip Russian stocks and emerging market bonds.
- The trades are then settled via a custodian network.
- Simultaneously, or very soon after this, the Russian brokerage sells an identical quantity of the same securities to a financial institution in Europe, in exchange for non-rouble currency, typically euros.
- This trade is also settled via the custodian network, and the non-rouble funds are credited to a custodian account belonging to the Russian brokerage.
- The brokerage then transfers the funds to a shell company controlled by the individual or entity who originally wished to move funds out of Russia. These shell companies were often in key jurisdictions including Latvia, Cyprus and UK LLPs.

- Although Russia is used in this example, this typology also applies to other countries where corrupt elites or OCGs are seeking to transfer significant illicit value to a different country and currency from the origin of the assets.

Identifiers, Indicators and AML Weaknesses

The features, behaviours and AML weaknesses identified relating to mirror trading are outlined below. Full findings can be found in the table in Annex A while below is a summary of key red flags. These findings are intended to provide recipients with an overview of factors within financial institutions which facilitated the mirroring trading typology.

This alert does not contain guidance on how to detect or prevent the red flags identified. While an 'MLTM Risk Mitigation' section can be found on p.10, the EWG has also issued a supplementary alert '0612- NECC Risks and Vulnerabilities for Money Laundering Through Capital Markets' which outlines general vulnerabilities of the capital markets and lists a number of challenges posed by MLTM which entities may wish to consider when implementing amendments to AML frameworks and relevant controls within their institution. We recommend you read the two alerts in conjunction to gain a better understanding of MLTM risks.

Recipients of this Alert may be involved at any stage of the mirror trading cycle. This could be as a custodian, broker, executor, intermediary or provider of banking services. It is therefore recommended that you consider at which point your firm could be involved in the mirror trading typology and which indicators you could potentially see.

KYC Gaps

- A lack of Front Office ownership over KYC responsibilities and the view that KYC is a back office function led to a failure to properly understand clients and their intended business activity.
- Process driven KYC at onboarding resulted in 'tick-box' exercises rather than gaining a true understanding of the clients. As a result, important factors were missed including verifying ultimate beneficial ownership, underlying source of wealth and funds, and links to high-risk jurisdictions or suspicious entities.
- Extra difficulties are encountered when the direct client is a broker or intermediary acting on behalf of other underlying clients (also known as knowing your customers' customer, or KYCC). In these instances, insufficient information was obtained relating to the brokers' business model and underlying clients (e.g. source of wealth, jurisdiction, economic rationale).
- Ongoing monitoring and KYC failed to detect clients acting out of line with expected business activity. This included considerable differences in terms of amounts traded, buy and sell patterns and the types of products traded.

Products and Transactions

- Lack of economic rationale for the trades including a slight loss or disinterest in profit. Examples include a disinterest in obtaining the best price, lack of concern over losing money or lack of interest in the underlying product.
- Highly liquid securities can facilitate quick buying and selling in a steady market. Specific securities included: emerging market government bonds (Russia and Brazil); local blue chip corporate stocks (infrastructure and natural resource sectors); American Depositary Receipts; and Global Depositary Receipts.
- Trading and sales desks did not detect and/or escalate simultaneous buy and sell orders for the same quantity of the same security, either by the same or different entities.
- Transactions out of line with expected business activity, including heavily weighted trading on either the buy and/or sell side only or net one way currency flows.

Variety of Market Participants

- Multiple market participants in a single transaction increase the distance between trade counterparties and add layers between the underlying clients and executors of a trade.
- Many participants in a single transaction only have a partial view over the end-to-end transaction. This reduces transparency and impedes institutions' understanding of the transaction, for example economic rationale or end clients.
- Criminal actors may deliberately add extra layers to the transaction cycle in an attempt to evade detection. This could be through the introduction of brokers to place orders and create distance between the client and executing firm; custodian networks to reduce visibility over destination of funds; or shell companies to obscure ultimate beneficial ownership.

Staff Conduct

- Personal relationships or over-familiarity with clients can be exploited, for example exerting influence over work-place behaviour or sharing information on internal monitoring and controls.
- Inappropriate or insufficient personal or work-place relationships between trading and compliance staff can lead to failures to maintain appropriate standards or apply sufficient controls.
- Staff undertaking tasks that are outside of their remit and thus gaining control over a larger portion of the business activity than is intended, can lead to the circumvention/removal of internal controls or the evasion of potential risk identification triggers.

Risk Mitigation

The risk areas outlined above are sizeable and can challenge attempts to prevent and detect MLTM activity. Nonetheless, an assessment of the indicators and vulnerabilities below can provide some useful pointers to be considered when building MLTM-specific models into AML frameworks and controls. In particular:

- The importance of robust KYC at the onboarding stage and on an ongoing basis.
- The importance of understanding a client's trading and activity profile with only a partial view of the end-to-end transaction
- The importance of MLTM engagement, training and awareness raising with Front Office staff.
- Considering where you could sit in a single suspicious activity and what you could potentially see.

Note: these indicators are intended to provide recipients with an overview of factors within financial institutions which facilitated the mirroring trading typology.

What it facilitates	Purpose	Mechanism
	<ol style="list-style-type: none"> 1. The conversion of one currency to another. 2. The transfer of value from one jurisdiction to another. 3. Individuals to move money cross-border without detection. 	Allows for value to be moved across borders in the form of securities, which are not subject to the same cross-border checks as money.
Typology Evolution	Diversification / Development due to displacement	
	<ol style="list-style-type: none"> 1. The buy and sell side trading activity occurring at different financial institutions. 2. Brokers being introduced as an additional layer. This could be a deliberate step by criminal actors or due to larger institutions exiting suspicious clients. 3. Clearing through custodian networks being introduced as an additional layer. 3. Asymmetrical balancing, whereby the entities on both the buy and sell side of the trade buy and sell in unequal measures to evade detection controls (e.g. wash trading or repetitive one way trading). 4. Longer holding periods before the second leg of the trade is executed. 5. Potential for as yet unidentified diversification or development. 	
Red Flags, Vulnerabilities, and Areas for Exploitation		
Products	Qualities / Products Identified	Attractive Features
	Highly liquid securities.	High liquidity appears to facilitate the quick buying and selling of securities within a steady market. While liquidity itself is not a red flag, it can make it quicker and easier to sell a stock onwards.
	Over the counter (OTC) trades.	OTC trades can facilitate opacity as they do not have a central oversight body. They also facilitate the selection of a trade counterparty, allowing two entities to act in coordination.

Transactions & Client Trading Activity	<p>Specific products include:</p> <ul style="list-style-type: none"> • Emerging market government bonds (including Russia and Brazil). • Local blue chip corporate stocks (including in infrastructure and natural resource industries). • American Depositary Receipts. • Global Depositary Receipts. 	<p>It is important to note that these securities in themselves are not 'risk' products; however, some of their features make them attractive to criminals to abuse. For example, large market size, relative price stability, high liquidity, low-risk, and low-profile nature of a security are all attractive features.</p>
	<p>The possibility for the mirror trading technique to be replicated across different product divisions.</p>	<p>Other products may be equally vulnerable to the typology if they present similar opportunities for moving value cross-border whilst circumventing normal controls.</p>
	<p>Red Flags</p>	<p>Suspicious</p>
	<p>Desks receiving buy and sell orders for the exact same quantity of the same security almost simultaneously. The orders may be by the same or different client, albeit with the same underlying beneficial ownership.</p>	<p>These mirrored trading patterns could be indicative of the scheme, especially if the client appears not to be making a gain, as they show the movement of value from one jurisdiction to another with no apparent economic rationale. This could suggest that the client is interested in moving the security rather than making a profit.</p> <p>An economic rationale may exist for this. However, in these circumstances understanding the client's business model is imperative.</p>
	<p>Desks receiving buy and sell orders for the exact same quantity and product but the two legs are in different currencies. These orders may be by the same or different client, albeit with the same underlying beneficial ownership.</p>	<p>These mirrored trading patterns could be indicative of the scheme, especially if the client appears not to be making a gain. The different currencies could indicate that the client is interested in moving the security and changing the underlying currency too, rather than making a profit.</p>

	An economic rationale may exist for this. However, in these circumstances understanding the client's business model is imperative.
Buy and sell orders for the same quantity and product by the same intermediary or individual, however on behalf of different underlying clients.	This could suggest a commonality in ownership between the underlying clients. It is always important to understand the economic rationale behind the activity.
Client transactional activity heavily weighted towards either buying or selling.	This could raise suspicions if the expected client activity was for a balanced trading profile and could suggest that the entity is interested in moving value. Clients acting outside of their expected activity profile could be indicative of potential MLTM.
No economic rationale for the transaction. The client may show a disinterest in obtaining the best price, a lack of concern over losing money, or a lack of interest in the underlying product.	This could indicate that the client is not interested in making any gains, which is not 'normal' business behaviour. They would therefore have another purpose behind the transaction which may not be clear.
Client accounts may show a loss or only a slight gain in relation to high volumes of trading. This may also be reflected in a lack of strategy or commercial rationale when a client's overall trading activity is reviewed.	This weaker performance may not be expected, may not make economic sense and/or may be out of keeping with other similar clients. If their purpose is not to make money, then the business purpose of their trading activity needs to be understood.
Client transactional activity showing net one way currency flows (e.g. RUB-USD).	This could be indicative of client intentions to convert value from one currency to another.
Small transactions typically under 10m.	These are not necessarily suspicious in themselves however were a common feature in identified examples, and when aggregated with any of the other flags highlighted raise the level of suspicion.
Deficiencies	Impact

Onboarding, Due Diligence, Ongoing KYC, Client Behaviour	<p>A lack of clarity over KYC responsibilities, with Front Office staff seeing KYC as a back office function.</p>	<p>Unclear delineations of KYC responsibilities can lead to a lack of 'ownership' over client onboarding requirements and subsequent KYC failures. In many cases the KYC responsibilities of Front Office staff were not adequately enforced. This led to failures in initial and ongoing KYC, including understanding the client, its ownership, source of funds, business model and expected trading activity.</p>
	<p>A process driven KYC whereby a tick list operation was performed rather than gaining a true understanding of the client and its business.</p>	<p>While necessary documents and information were obtained, there was insufficient review of this information to fully understand the nature of the client and its business. Gaps and contradictions were not identified and therefore additional clarity was not sought from the client.</p>
	<p>A failure to detect discrepancies between the expected business activity and actual business conducted.</p>	<p>Ongoing client monitoring and KYC failed to detect, either manually or systems based, discrepancies between the expected business profile stated at onboarding and actual activity conducted. In many instances these differences varied widely in terms of amounts traded, buy and sell patterns, and the types of products traded.</p>
	<p>Clients onboarded in different jurisdictions being able to trade in the UK without the London desk knowing.</p>	<p>In some instances, onboarding teams were able to onboard new clients in one jurisdiction without any involvement from front office staff in the UK. Consequently, front office staff did not know or understand the client they were trading on behalf of.</p>
	<p>Ongoing client monitoring and KYC failed to detect, either manually or systems based, discrepancies between the expected business profile stated at onboarding and actual activity conducted. In many instances these differences varied widely in terms of amounts traded, buy and sell patterns, and the types of products traded.</p>	<p>A failure to detect discrepancies between the expected business activity and actual business conducted.</p>

	<p>A lack of understanding over the client's underlying client base when they were a broker or third party acting on behalf of a pool of other parties. Know your client's client (KYCC).</p>	<p>Whilst it is not a legal requirement to conduct KYCC it was found that inadequate attempts were made at understanding the broker's business model more generally. For example, who the broker was dealing on behalf of, how often they would be trading, the purpose of the transactions, the jurisdictions involved for the underlying client base, the general source of wealth of the end clients, and the underlying economic rationale for the trading activity.</p>
	<p>An inadequate understanding of the legitimacy and ultimate source of wealth of the underlying funds.</p>	<p>In many cases the ultimate source of wealth was unknown. In others the explanations did not make sense however the inconsistencies were not detected. KYC information received was not adequately reviewed to identify contradictions and information gaps, and further questions were not asked of the client to seek clarification. In instances where the clients were brokers dealing on behalf of a pool of their own clients, insufficient information was obtained in relation to identifying the underlying client base and source of wealth.</p>
	<p>An inadequate understanding of the ultimate beneficial ownership, and the relationships or commonality between clients.</p>	<p>Many clients were linked to shell companies (including UK LLPs and in offshore jurisdictions), opaque ownership trails, nominee directors, lawyers, other suspicious entities and high-risk jurisdictions (including Russia, former CIS countries and Baltic states). However, the opacity was not questioned and attempts at understanding the true ultimate ownership were inadequate.</p>
	<p>An inadequate understanding of the relationship or commonality between underlying clients on each side of the trade. Sometimes this would be further concealed by the addition of a broker as an additional layer.</p>	<p>In many cases the ultimate ownership on both the buy and sell side was the same however this was not detected. Commonly this was due to insufficient attempts at understanding the client, and the underlying source and wealth of the funds. In many cases entities may wish to use intermediaries in order further conceal their relationship to one another.</p>

	An inadequate understanding of the client's business model and the purpose of the relationship.	Insufficient information was gathered and analysed in relation to why the client wanted the trading relationship, details of activities it would be undertaking (volumes, amounts, products, frequency etc.) and the purpose and benefit of the transactions. This was a fundamental gap in the KYC process.
	Reliance on information provided by the client without corroboration.	Information provided by the client was accepted without corroboration meaning that discrepancies, gaps and contradictions were not identified, and deficient KYC files approved.
	A lack of face-to-face contact between the client and the financial institution.	Front office staff did not really know their client base, lowering the levels of legitimacy and trust to be placed on the relationship.
Risk Assessments	No single repository of KYC information and/or no unique identifier for each client.	No single identification code was given to each individual client which led to a lack of reconciliation between the trading and customer onboarding processes. As a result, financial institutions were not always able to determine who the clients undertaking the trades.
	<p>Flawed risk assessments failed to take into consideration the risks associated to:</p> <ol style="list-style-type: none"> 1. The type of legal entity being onboarded (e.g. shell company). 2. Different delivery channels. 3. Level of face-to-face contact between client and the financial institution. 4. Corroboration of the jurisdictions involved. 	Flawed risk assessments meant that the existence of higher-risk money laundering factors could not be appropriately assessed, for example shell company structures, nominee directors, or links to high-risk money laundering jurisdictions. Different delivery channels were also not included, meaning that the risk assessments failed to pick up on factors such as relying on brokers' KYC on the end client base or opacity of knowing who is behind a custodian network account. Lastly face to face meetings were not documented in the risk assessments which could have increased/decreased risk scores.
	Entities Identified	Impact

Distribution Channels, Intermediaries and Vehicles	<p>The following distribution channels, intermediaries and/or vehicles were identified as adding layers and opacity to the suspicious trades:</p> <ul style="list-style-type: none"> • Brokerages • Custodian Networks • Shell Companies 	<p>Multiple market participants and the inclusion of certain corporate vehicles in any one transaction create layers which place financial institutions further away from the end clients. This creates opacity by providing only a partial view and limited understanding of the end-to-end transaction.</p> <p>With brokers acting on behalf of end clients and trades being cleared through custodian networks, financial institutions are further detached from the end client, do not necessarily know the underlying source of wealth, and often rely on the KYC of those third parties. Shell companies hid true beneficial ownership and enabled individuals/entities to be onboarded who may otherwise not have been.</p>
	<p>New relationships with new or smaller brokerages with whom an institution did not have a good or existing relationship - the brokerage is being used solely for ML.</p>	<p>The use of smaller brokerages with which there is a lack of a trading relationship can obfuscate the activity expected from a relationship as there is no baseline of activity. Smaller brokerages are likely to have a target clientele, and thus a predictable level and type of activity which may not correlate to identified activity; this would be clearer where there is an existing relationship. Additionally, smaller brokerages may be more vulnerable to exploitation and takeover by sophisticated OCGs seeking to utilise them for ML, and may trigger lesser scrutiny than more active, larger alternative brokerages.</p>
Jurisdictions	Jurisdictions Identified	Jurisdiction Relevance
	<p>Some of the key jurisdictions identified in the scheme include:</p> <ul style="list-style-type: none"> • Russia • Latvia • Estonia 	<p>These jurisdictions were linked to all parts of the transactional cycle, including the end clients, brokers acting on behalf of other clients, shell companies, nominee directors and bank accounts receiving end funds. They also all feature commonly across other money laundering typologies and could have been</p>

Internal Conduct Behaviour	<ul style="list-style-type: none"> • Moldova • Cyprus • Seychelles • BVI • UK (LLPs) 	detected and taken into account through adequate KYC processes.
	Behaviours Identified	Impact
	Personal relationships or over-familiarity with clients.	Over familiarity between employees and clients may provide opportunities for exploitation including inappropriate levels of influence and the provision of information facilitating the evasion of systems and controls, whether through intention or neglect.
	Inappropriate or insufficient personal or work-place relationships between trading and compliance staff.	Over familiarity between trading and compliance staff may allow for a neglectful or intentional failure to maintain appropriate standards or apply sufficient controls. Equally, a hostile or distant relationship may negatively impact the ability of compliance staff to employ effective oversight, scrutiny and identification of compliance/risk issues. For example, in some cases, the lack of familiarity prevented easy information sharing for compliance review.
Staff undertaking tasks that are outside of their remit without detection internally. This included the circumvention/removal of information barriers and the dissemination of sensitive information between departments.		In some cases staff were able to take charge of tasks outside of their remit, where there was a lack of active scrutiny or oversight. As a result certain individuals were able to gain control over a larger portion of the overall business activity than is intended, while potential risk identification triggers were evaded. For example, employees were able to circumvent/remove controls such as information sharing barriers intended to prevent conflicts of interest or disseminated sensitive information between departments.

Suspicious Activity Reporting

If you know/suspect ML or terrorist financing activity you should make a SAR and include the reference **0611-NECC** within the text *in addition* to the ongoing use of the Glossary of Terms.

Guidance on reporting is available at: www.nationalcrimeagency.gov.uk.

Further Reading

This alert does not contain guidance on how to detect or prevent the red flags identified. While it includes a 'MLTM Risk Mitigation' section a supplementary alert (0612- NECC Risks and Vulnerabilities for Money Laundering Through Capital Markets) has been issued which outlines general vulnerabilities of the capital markets and lists a number of challenges posed by MLTM which entities may wish to consider when implementing amendments to AML frameworks and relevant controls within their institution.

We recommend you read the two alerts in conjunction to gain a better understanding of MLTM risks.

Data Protection Considerations

Please consider your obligations under the relevant data protection regulations and where necessary remove any related personal data from your systems securely and within a satisfactory timeframe.

Disclaimer

The Accountancy AML Supervisors' Group (AASG) accepts no responsibility for any loss, damage or expense arising in connection with the use of information in this alert. Any use will be taken to signify agreement to these conditions.