Effects of Trade-Based Money Laundering on Banking Sector

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ABSTRACT
Trade-Based Money Laundering (TBML) is one of the most intricate and underreported forms of illicit financial activity, posing substantial risks to global banking systems. This study investigates the effect of TBML on the banking sector, focusing on how increasing occurrences influence share prices i.e. a proxy for investor confidence, and overall bank valuation. Using a quantitative design, secondary financial data from publicly listed banks were analysed, incorporating variables such as Earnings per Share (EPS), Dividend Yield, and TBML event occurrences. Econometric techniques, including descriptive statistics, correlation, and multiple regression in EViews, were employed to assess causal relationships between financial indicators and stock performance. Findings reveal that TBML incidents have a statistically significant long-term negative impact, driven by market inefficiencies, information asymmetry, and delayed regulatory disclosures. The study addresses a critical gap in financial crime literature and calls for enhanced regulatory transparency, investor education, and robust compliance measures to mitigate systemic risks.
Keywords:
Trade-Based Money Laundering, Banks, Banking Sector, Stock Price, Earnings Per Share, Dividend Yield, Market Confidence, Pakistan.

Introduction

Money laundering refers to the process of legitimising illegally acquired wealth by concealing its illicit origins (Rajamanickam et al., 2021). Funds obtained from activities such as drug trafficking, corruption, and organised crime must be 'cleansed' before entering the legitimate financial system without drawing suspicion. Among the various laundering methods, Trade-Based Money Laundering (TBML) is considered one of the most complex. It operates

through legitimate-seeming trade transactions involving the shipment, import, or export of goods and services, enabling value transfer across borders under the guise of lawful commerce. Other techniques include misuse of financial institutions and bulk cash smuggling. Client due diligence becomes particularly challenging when transactions span multiple jurisdictions with different regulatory frameworks. The International Money Laundering Information Bureau (IMLIB) ranks money laundering as the third-largest global industry after currency trading and oil (Richard, 2020).

Under the Financial Crimes Enforcement Law (2025), money laundering is defined as "disguising the financial assets so that they can be exploited without the recognition of any activity which is illegal which build them." The Financial Action Task Force (FATF, 2006) similarly defines TBML as the use of trade transactions to "hide proceeds of the crime and shift the worth… in order to legitimate their criminal origin" or finance illicit activities (FATF, 2008). Common TBML schemes include invoice manipulation, misrepresentation of goods or services, and repeated billing due to pricing inconsistencies or measurement discrepancies (Tiwari et al., 2024). The Government Accountability Office (GAO, 2019) has noted that nearly 80% of foreign trade handled by financial institutions occurs on an open-account basis, bypassing direct bank involvement and traditional anti-money laundering (AML) checks. While Suspicious Activity Reports (SARs) are designed to alert authorities such as FinCEN, their effectiveness is limited, especially in open-account transactions.

These challenges are compounded by faults in the international trade system. As per the estimates, trade-based money laundering (TBML) constitutes about 30% of all money laundering conducts. Yet, in 2019, only 0.2% of the 1.15 million money laundering stating TBML (Kim, 2020) inflowed. These TBML discrepancies are concerning and draw attention to glaring gaps in TBML detection. TBML is difficult to uncover because the illicit trade flows are embedded within the legitimate trade activities (Marzouk, 2021; Naheem, 2018; Fakih, 2022). Banking institutions' risk assessment frameworks for TBML detection often miss complex schemes involving invoicing, multijurisdictional, and shell companies (Naheem, 2018; Fakih, 2022; Naheem, 2019). High-risk countries also grapple with obsolete monitoring frameworks and thinly staffed regulatory bodies that lack motivation due to low regulatory incentives (Marzouk, 2021; Naheem, 2019).

Attempts to resolve issues with governance have proved futile. Numerous institutions adopt a reactive approach, dealing with flagged transactions only after they have been processed (Naheem, 2019). Some jurisdictions impose reporting restrictions that result in banks truncating the data transferred to the financial intelligence units to avoid penalty for purportedly inaccurate reporting (Naheem, 2018). This blend of insufficient, reactive enforcement, touted leaky frameworks, and uneven regulatory frameworks leaves significant room for TBML to persist.

Criminals' increasing sophistication in concealing illicit proceeds makes TBML one of the most enduring and damaging forms of financial crime. While penalties and awareness have elevated, the complexity of international trade, differing jurisdictions, and the delays of access to trade data significantly impede TBML detection capabilities. Moreover, there is a lack of publicly available data and studies on the impact of TBML on publicly listed banks and stock market operations. Even when there is no clear evidence of TBML, reputation, regulatory, or even

investor confidence issues are attributable to merely TBML allegations or even investigations, impacting market capitalization and stock price.

The TBML market confidence and bank valuation study aims to fill the gap in literature by reconstructing TBML disclosures and their impact on bank stock prices. The study will analyze whether TBML disclosures signal reputational, investor trust, or confidence damage. It aims to capture both price changing and price stabilizing TBML-related events. It will also analyse their impact on share price volatility, trading volume, currency trading, and overall market sentiment. The current study efforts to fill a major gap in understanding Pakistan's asset management industry. It evaluates the interactions of risk-adjusted returns (RAR), market share (MS), managerial experience (EXP), and assets under management (AUM), and how these factors together impact outcomes in the industry. By understanding these relationships, the study seeks to benefit asset managers formulate better growth plans, enable informed decision-making for investors, and provide opening policy recommendations to regulators aimed at nurturing market stability and sustainable growth.

The scope also includes regulators, financial institutions, compliance experts, and even policy makers. It precisely looks at the relationship between trade-based money laundering (TBML) and market presentation to provide empirical evidence useful for refining anti-money laundering policies, improving institutional detection frameworks, and promoting transparency in the market. Thus, it addresses the underexplored areas of financial crimes in the literature and offers realistic, and policy recommendations aimed at lowering the systemic risk that TBML poses to financial markets.

Literature review

In scholarly and regulatory circles, Trade Based Money Laundering (TBML) is known as one of the most sophisticated and elusive forms of financial crime, particularly in international trade. Unlike traditional forms of money laundering which relies on cash and bank transfer systems, TBML employs a trade system to disguise its operations. Mispricing, over- or under-invoicing, multiple invoicing, fictitious shipments, and non-existent goods all aim to conceal the source, ownership, and movement of illicit funds TBML works to hide. The system disguising as a trade system has its intricacies, and when coupled with the loose oversight of the regulatory framework, distinguishing between valid and invalid transactions is extremely hard. The very systems that are meant to promote legit trade enable TBML to thrive without detection.

A mounting collection of literature associates TBML not only with criminal and regulatory issues, but with its more far-reaching impacts on the economy and finance, especially concerning fluctuations in share prices and overall market activity. Non-financial risk factors such as policy breaches, corporate misbehaviour, and uncertainty of regulations are, in fact, the consequences of financial theory. Therefore, TBML-related disclosures could indeed act as negative market endorsements and consequently alter investor perceptions and trading activity. Recent studies highlight the need of addressing TBML with cross-border collaboration, the use of high-end analytic and AI tools in Anti-Money Laundering (AML) processes, more stringent corporate governance, and strong TBML corporate governance. My focus in this study extends on testing empirically the link of TBML exposure with stock market activity, thus narrowing it down to the banking industry.

Origin of Trade-Based Money Laundering

In academic and professional circles, TBML had previously received in-depth coverage well prior to its official acknowledgment by FATF in 2006. It is worth mentioning the pioneering works of Bhagwati (1974), Wulf (1981) and Cuddington (1986) who in a sense, TBML years ahead of its formal recognition, studied trade mis-invoicing as a potential avenue for obtaining capital illegally. Later research expanded the argument by identifying typologies, transaction structures, and liabilities in trade finance systems.

The literature does highlight evidence-based detection models' theory shortcomings, pointing out methodological operational challenges due to insufficient data, international collaboration bottlenecks, and laundering network adaptability. Studies emphasize the need for borderless enforcement TBML tackles with trade reporting, advanced stat-modelling, and enhanced transparency (Naheem, 2020; Napier, 2023).

Global Economic Scale of TBML

TBML operates on a scale that has significant implications for the global economy. As Napier (2023) notes, it involves fraudulent manipulation of trade transactions to disguise and transfer criminal proceeds into the legitimate financial system. Techniques range from complex invoicing schemes to misdeclaration of goods, often facilitated by intermediaries and shell companies. In some cases, TBML also involves cross-border flows of prohibited or controlled goods, further blurring the line between legitimate and illicit commerce.

There is a substantial gap TBML research filling, and it focuses on the macroeconomic and market TBML effects. Existing literature is mostly concerned with estimating the volume of illicit trade, with very few addressing the impacts on a firm's financial performance (GFI, 2023). This gap is mainly stark in the context of stock market activity, where revelations or investigations related to TBML would dramatically impact investor sentiment, market activity, and the steadiness of share prices.

Impact on the Banking Sector

In the banking industry, TBML carries substantial compliance and operational risks. Some scholars have proposed global customs data-sharing initiatives and enhanced internal financial system controls as countermeasures. Naheem (2019; 2020) notes that even with the above implementations, the quality of the data, appropriate coordination between jurisdictions, and technology capabilities still present issues. Furthermore, with the tower of overcomplicated risk assessment models that banks utilize, they are unable to identify sophisticated TBML patterns to multijurisdictional frameworks and shell companies (Marzouk, 2021; Fakih, 2022).

Detection Challenges and Regulatory Frameworks

As indicated by the International Finance Corporation (IFC, 2024), TBML hampers the growth of the private sector, hinders domestic revenue mobilization, and diminishes confidence in the public markets. The FATF established the "40 Recommendations" as International AML/CFT frameworks as TBML guidelines to assist countries in detection and prevention. The guidelines are primarily focused on advanced technology adoption, artificial intelligence, and mutual evaluations with data-shaming non-compliant countries.

Financial institutions use Know Your Customer (KYC) processes to monitor customer transactions, identify Tai and suspicious activities, and train employees. Governments use

legislation to coordinate intelligence-sharing between units and operate FIUs to centralize data collection and distribution. International cooperation stays necessary, as TBML schemes frequently exploit regulatory gaps involving jurisdictions (FATF, 2006; Naheem, 2018).

Reputational Risks and Market Perception

From a market perspective, TBML exposure can trigger significant reputational damage. Under the Efficient Market Hypothesis (EMH), such events are treated as material disclosures capable of influencing both short- and long-term stock performance. Empirical evidence demonstrates that banks involved in money laundering scandals have experienced sharp declines in share prices following public disclosure (UNODC, 2023). These declines often reflect investor reconsideration of a firm's internal controls, risk culture, and overall transparency.

Theoretical Background

Trade-Based Money Laundering (TBML) has strategic implications on an organizational level and on an international scale as it supports organized crime, terrorism, and corruption. It damages economic stability, erodes social cohesion, and damages trust in a society in a country dependent on trade and capital inflows (Sivaguru & Tilakasiri, 2023; Kumanayake, 2015; Sinno et al., 2023). The scale poses a threat in facilitating billions of dollars in illicit capital flows which calls for urgent international collaboration. In any case, firms in the financial sector treating TBML as a strategic reputation risk instead of a compliance obligation. Active avoidance of risk and protecting market reputation through advanced and proactive detection systems, good TBML Governance, TBML transparent governance, and international best practices TBML protocols.

Hypothesis Development

Recent The literature identifies a relationship between the Trade-Based Money Laundering (TBML) and the performance of banking institutions, especially in the context of the banking sector's operations and market activities. It is suggested that illicit financial transactions, in one way or another, influence the operations and market activities of financial institutions. TBML markets signal theory suggests that investor sentiment and risk perception diminishes and share price performance changes for better or for worse, directly or indirectly in reaction to TBML disclosures.

Based on the theoretical frameworks and empirical findings given in the literature review, the following hypotheses are proposed:

H1: Trade-Based Money Laundering (TBML) incidents have a statistically significant negative impact on bank share prices in the short term.

H2: TBML incidents have a statistically significant long-term impact on bank share prices, reflecting sustained reputational and operational effects.

H3: TBML incidents are negatively associated with Earnings Per Share (EPS) of banks, indicating a potential link between illicit financial activity and profitability metrics.

H4: TBML incidents are negatively associated with dividend yields, signifying a possible effect on shareholder revenues.

These hypotheses aim to empirically assess the level to which TBML exposure influences market performance pointers in the banking industry, thereby covering the gap between theoretical claims and observable financial outcomes.

Research Methodology

This study utilizes quantitative research methods based on a positivist framework to measure Trade-Based Money Laundering's (TBML) impact on bank stock value through incident TBML's stock value correlation. The study aims to measure TBML disclosures and market investigations to determine their significant impact on market value perception of shares while controlling other financial indicators of EPS and DY. Integrating criminology and financial economics, the study impacts policy and managerial regulations through the evaluation of TBML's marginal effects.

Secondary data was employed for its reliability, standardisation, and longitudinal coverage, crucial for econometric analysis. MPS serves as the dependent variable, with EPS, DY, and TBML occurrence as independent variables. Data were sourced from audited bank annual reports and financial statements, financial databases such as Investing.com and Yahoo Finance, and TBML enforcement records from regulatory authorities. TBML events were coded as a binary variable (0 = event occurrence, 1 = no event) for the 2020–2025 period. Banks were selected based on prior TBML enforcement history, availability of complete financial statements, and consistent stock performance reporting, ensuring comparability across the sample (Saunders, et al., 2019). The dependent variable, MPS, reflects market valuation per share, while EPS measures profitability and DY reflects shareholder returns. The model applies multiple linear regression as follows:

$$\text{MPS}_{it} = \beta_0 + \beta_1(\text{TBML}_{it}) + \beta_2(\text{DY}_{it}) + \beta_3(\text{EPS}_{it}) + \in$$

Here, MPS_{it} is the market price per share for bank i at time t, TBML_{it} is the dummy variable for TBML events, DY_{it} is dividend yield, EPS_{it} is earnings per share, and $\in$ is the error term. This panel data approach accounts for unobserved heterogeneity across banks and over time.

Data analysis was conducted using EViews software for descriptive statistics, correlation, and regression modelling. Descriptive statistics summarised data distribution and identified anomalies, while correlation analysis examined inter-variable relationships, with multicollinearity tested through the Variance Inflation Factor (VIF). Regression analysis determined the direction, magnitude, and statistical significance of relationships between TBML events and financial indicators.

Ethical considerations were detected by using only publicly accessible and reputable data sources, avoiding any direct participation of human participants or sensitive info. All references followed Harvard-style citation, and data governance protocols were adhered to, guaranteeing academic integrity.

Limitations include restricted availability and accuracy of TBML event data due to its covert nature, possible lagged effects on MPS, and unobserved factors such as governance or media influence. The study's focus on a specific banking sector limits generalisability to other industries or regions
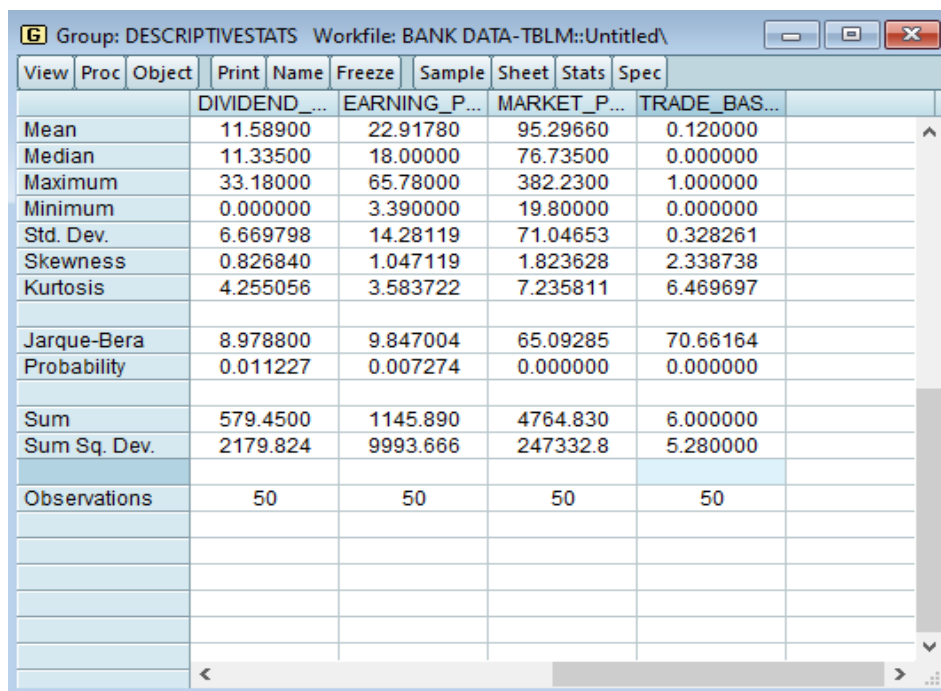
Data Analysis Findings

The empirical analysis followed a structured sequence comprising **descriptive statistics**, **correlation analysis**, and **multiple regression** modelling, enabling a comprehensive assessment

of the relationship between Trade-Based Money Laundering (TBML) incidents and bank stock performance indicators.

Descriptive Statistics

Variability emerged in the data set as seen in the descriptive statistics. Marked volatility in equity valuation as a Market price per share (MPS) ranging as high as 382.23 and as low as 19.80 with a mean of 104.79. EPS's historically high value of 65.78 and low of 3.39 with an average of 17.14 revealed significant profitability among banks, supporting the claim of high dispersion among bank profitability. DY showcasing an average of 11.59 percent with significant deviation demonstrated differing policy among shareholder returns.

	DIVIDEND_...	EARNING_P...	MARKET_P...	TRADE_BAS...
Mean	11.58900	22.91780	95.29660	0.120000
Median	11.33500	18.00000	76.73500	0.000000
Maximum	33.18000	65.78000	382.2300	1.000000
Minimum	0.000000	3.390000	19.80000	0.000000
Std. Dev.	6.669798	14.28119	71.04653	0.328261
Skewness	0.826840	1.047119	1.823628	2.338738
Kurtosis	4.255056	3.583722	7.235811	6.469697
Jarque-Bera	8.978800	9.847004	65.09285	70.66164
Probability	0.011227	0.007274	0.000000	0.000000
Sum	579.4500	1145.890	4764.830	6.000000
Sum Sq. Dev.	2179.824	9993.666	247332.8	5.280000
Observations	50	50	50	50

Figure 1: Descriptive Statistics

TBML events were quite rare, with a mean value of 0.12, demonstrating that most banks in the dataset did not experience a recorded TBML-related enforcement action in the duration. Skewness and kurtosis statistics, along with the Jarque–Bera test, confirmed that none of the variables followed a normal distribution, reinforcing the appropriateness of strong econometric techniques.

Correlation Analysis

This analysis provided initial insights into variable relationships. EPS proved a strong and statistically substantial positive correlation with MPS ($r = 0.87$), supporting the idea that higher profitability drives share valuations. DY was moderately correlated with EPS ($r = 0.36$) and MPS ($r = 0.28$), aligning with dividend signalling theory but indicating that its role is secondary compared to profitability.
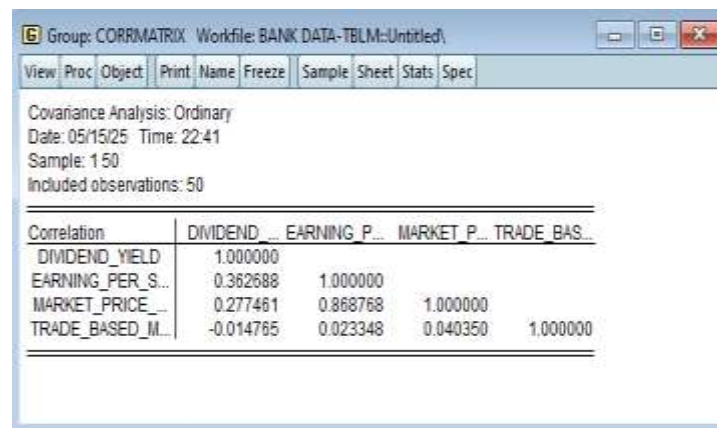
Figure 2: Correlation Analysis

TBML event occurrence exhibited negligible correlations with other variables, indicating that the market may not respond strongly to TBML disclosures in the short term unless accompanied by significant reputational or financial results.

Regression Analysis

The regression analysis was done using the multiple linear regression approach with MPS as the dependent variable and EPS, DY, and TBML events as independent variables. The model's performance can be considered reasonable, with an Adjusted R^2 of 0.741, which means roughly 74.1 percent of the change in market prices was effectively captured by the chosen predictors.

Figure 3: Regression Analysis

The overall model was significant, and the predictors used in the model had a significant relationship with the dependent variable (F-statistic > 0.001). EPS had a positive and highly significant coefficient ($\beta = 4.40$, $p < 0.01$), which confirms the overwhelming importance of EPS in determining the valuations of the banks. DY had a negative coefficient, which was also statistically not significant ($\beta = -0.46$, $p = 0.586$), indicating that dividend yield by itself does not significantly impact share prices, provided that the company's profitability is considered.

TBML events had a positive coefficient of 4.13. But, this result was not statistically significant ($p = 0.794$). This supports the perception that the impacts of TBML may be delayed, hidden due to underreporting, or obscured by information irregularity.

From the analysis, it can be concluded that the investor sentiment in the banking industry seems to be predominantly tethered to profitability ratios, with compliance-related considerations, such as TBML, only affecting market valuations in a limited and lagged fashion. his highlights the need for regulators and policymakers to enhance transparency and disclosure models, ensuring that risks associated with illicit financial flows are adequately reflected in market behaviour.

Discussion

Financial Performance and Stock Valuation

The research highlights that financial performance has a considerable impact on stock valuation in the banking industry, especially with Earnings Per Share (EPS) being the most critical factor determining the market price per share (MPS). EPS has a positive effect, conforming to classical accounting theory which views profitability as a major factor driving a company's value (Damodaran, 2012; Penman, 2013). Investors tend to buy a bank's shares when profits are high, as they are viewed to signal good financial standing and offer substantial growth potential. On the other hand, DY and MPS are deemed to have no significant relationship. This could represent a sector-specific phenomenon where the focus is on long-term capital gains and reinvested profits rather than immediate dividend distribution. Regulations under Basel III tend to force banks to retain earnings to satisfy capital and reserve requirements, reducing the impact of dividend payout fluctuations on the market (Miller and Modigliani, 1961; Bhattacharya, 1979).

Trade-Based Money Laundering (TBML) Events and Market Response

A key objective of the study was to assess the impact of TBML incidents on bank stock performance. The regression analysis revealed that TBML events had no statistically significant short-term effect on MPS, despite a positive coefficient of 4.13. The p-value (0.794) suggests the influence is not consistent or reliable within the examined period. This outcome can be attributed to several factors.

Market Inefficiency and Underreaction

In emerging markets, where the risk of financial crime is less understood, the response from investors is sometimes slow. These markets grapple with the slow dissemination of critical information, which in turn, delays necessary market adjustments.

Information Asymmetry and Non-Disclosure

TBML is perpetually intricate in nature; it involves cross-border trade and documents that are impossible to authenticate (FATF, 2021). In the absence of regulatory filings or investigative journalism, the investors are likely to be oblivious to these activities and the activities and the market will be restricted in its ability to price in associated risks.

Lagged and Indirect Effects

The consequences of TBML, such as reputational damage, fines, or regulatory sanctions—often materialise long after the event. The study's time frame may not have been sufficient to capture these delayed impacts.

Regulatory and Legal Context

As highlighted by Global Financial Integrity (2023), TBML is one of the most underreported forms of ML. It is usually TBML that is most underreported and the cases that come to light are usually due to whistleblower claims or forensic audits. Furthermore, the lack of regulatory oversight adds to low market transparency of the events.

Implications of TBML's Market Invisibility

The lack of TBML activities, exposing the alleged insignificance, and their overall impact means that filings and investor communication need to be refined. In regard to non TBML activities, the focus is mainly the public lack of trust for the businesses and the trust in society at large. Essentially, these actions are devoid of any apparent TBML risks; therefore, practices such as irrefutable disclosure need to be implemented. In the words of trust, the primary focus of the long-term shareholder appeal and view TBML vis-a-vis the disclosure needs to be traditionally TBML.

In general, and in the context of short-term price, TBML events, alongside the lack of impact stock prices, remain the key driver in the earnings and underlying bank of shareholdings as key benchmarks for the economic performance. This shows a critical blind spot in market risk assessment, where illegal financial flows remain hidden until brought to light by enforcement or public exposure. Addressing this issue needs stronger regulatory frames and disclosure mechanisms to capture the systemic risks posed by TBML in financial markets.

Conclusion and Recommendations

Conclusion

TBML, or Trade-Based Money Laundering, is a involved scheme used by criminals to disguise the movement of illegal money through what seems to be legal trade. In attempting to cover up the movement of illicit funds, perpetrators engage in legitimate international trade. This form of money laundering is sophisticated, as it is both sophisticated and frequent TBML has unrelentingly enabled the falsified documentation, invoicing, and collusive trade account manipulation schemes that continue to erode the financial sector ever since the FATF raised awareness of TBML's threats back in 2006. TBML is not without its consequences. There is the potential, for the lack of proper detection, to face severe consequences ranging from fund flow corruption, human trafficking, tax evasion, currency control violations, and the evasion of importing high-value goods. In addition to these harmful acts, TBML has also disrupted trade data internationally, fosters practices that defy competition, and has perpetually drained capital from developing countries, stunting the mobilization of resources domestically.

In the light of a positive epistemology, this research adopted a quantitative design to investigate the relationship between TBML events and traditional financial performance statistics in the banking area. Using six years of secondary data (2020–2025) from financial statements, stock market databases, annual reports, and documented TBML incidents, the analysis focused on Market Price per Share (MPS) as the dependent variable, with Earnings per Share (EPS) and Dividend Yield (DY) as key independent variables alongside the occurrence of TBML events. A purposive sampling strategy ensured inclusion only of banks with publicly reported TBML-related investigations, consistent stock performance data, and comprehensive financial disclosures.

Investors are unable to appreciate to the full scope of risk due to the concealed trade documents, complex cross-border structure trade, absence of timely disclosure, and the inherently TBML's secretive, multi-jurisdictional nature. The lack of timely disclosure stemming from cross-border complexity and intricate secrecy blooms into a risk that goes unappreciated by investors. This risk is what creates the limits to the short-term response to the market. In regions with minimal media coverage or regulatory openness, especially within emerging markets, TBML-related

information is likely to be delayed, sparse, inconsistent, or lacking in detail, thus failing to adjust investor perceptions in a timely manner. TBML enforcement actions, monetary penalties, and damage to reputation tend to only impact the firmer penalties and damages much later.

This illustrates an important finding. This was demonstrated by Dyck, Morse, and Zingales in 2023, which suggests that regulators need to improve visibility and enforce more TBML disclosures by requiring public TBML investigations to improve market responsiveness. Active engagement in TBML risk assessment is necessary alongside traditional financial assessments, especially since muted short-term gains and TBML exposure erosion can pose long-term value. This TBML value erosion works in the opposite to the bank's TBML risk assessment prompt disclosures that enhance TBML market trust.

 The conclusion suggests that despite the lack of any immediate impact of TBML information on bank TBML shares, TBML shares do hold the risk of experiencing a delayed impact alongside any substantial impact. Addressing this blind spot will engage organized action across regulatory bodies, financial institutions, and international enforcement agencies. By keeping transparency, refining detection, and ensuring timely distribution of TBML-related information, the financial sector can rightfully protect both market integrity and investor trust, eventually contributing to a more robust and accountable global banking system.

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