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Counter Proliferation Financing

The threat of proliferation financing is an ever increasing and a concerning threat. The reality is that not all banks (and countries for that matter) understand what proliferation finance is, what it looks like, how to identify it and what measures to put in place to mitigate this risk.

"Governments need to share intelligence about proliferation and banks need to be scanning open source information to identify proliferation financing risk"

A 2010 FATF report by a project team comprised of international experts put forward the following working definition of proliferation financing: *Proliferation financing refers to the act of providing funds or financial services which are used, in whole or in part, for the manufacture, acquisition, possession, development, export, trans-shipment, brokering, transport, transfer, stockpiling or use of nuclear, chemical or biological weapons and their means of delivery and related materials (including both technologies and dual use goods used for non-legitimate purposes), in contravention of national laws or, where applicable, international obligations*.

In spite of there being a number of international treaties and country export controls regimes being put in place, proliferation financing for nuclear, chemical and biological weapons (referred to as Weapons of Mass Destruction – WMD) and their related delivery systems is an on-going occurrence and proliferators have been very innovative in how they go about obtaining the various components required to manufacture these weapon systems. In order to obtain the various components, proliferators need to access the formal banking system and embark on trade activities to support their illegitimate activities.

The role played by banks is thus a vital cog in the machinery of combating proliferation finance (CPF). North Korea continues to pose a significant threat and continues to gain access to the international financial system which is required to assist them in funding their development of WMD.

Identifying proliferation financing

Identifying proliferation financing is a difficult task. Proliferators purchase components of weapon systems as opposed to procuring full manufactured systems. These individual components often have legitimate uses making the identification for their illegitimate use even more difficult. Such components are referred to as dual-use goods as they have both commercial and military application.

Dual-use goods are difficult to identify and require specialist knowledge. Often general terminology is used to describe items which on the face of it, will not be deemed to be a dual-use good.

Dual-use goods are often obtained through a complex network of front companies, false documentation and common terms used to describe components. Financial transactions will be structured to avoid detection with the source of funds often being legitimate and the type of goods being obscured.

Obligations and their implementation

The UN Security Council Resolution 1540 – Non-Proliferation of Weapons of Mass Destruction ("UNSCR 1540 (2004)") is concerned with the proliferation of nuclear, chemical and biological weapons, as well as their means of delivery. Member states are required to implement a range of requirements to prevent proliferation financing, including targeted financial sanctions, activity based sanctions and sectoral sanctions. This is often supported by an export control regime.

They key elements of a CPF program are very similar to that of a money laundering and terrorist financing control program, namely:

- Having a robust customer due diligence requirement
- Profiling the customer so that the bank clearly understands who the customer is, what the customer does, why the customer wants to enter into a business relationship, and how the customer is going to transact through the bank.
- Having a robust screening regime to identify politically exposed persons and sanctioned persons
- The monitoring of transactions must be performed against the understanding of what proliferation financing looks like

Trade conducted on "open account" terms may pose higher risk due to the financial transfers carrying little information about the goods involved, shipping and other related information.

Governments need to share intelligence about proliferation and banks need to be scanning open source information to identify proliferation financing risk. Countries and Financial Institutions should conduct Proliferation Financing Risk Assessments. Such assessments are very similar to the ML/TF risk assessments. Understanding where the threat of proliferation financing would be the highest and then focussing on the products and transactions conducted by customers. An example would be identifying the proliferation financing risk in a bank providing services to the following segments:

- Private banking
- Retail banking
- Corporate and Investment Banking

Corporate and Investment Banking is likely to pose the highest risk in respect of proliferation financing. Understanding which countries pose a higher risk in respect of proliferation financing and then identifying which customers are trading with those countries, and what goods/services are being traded should be assessed against the known proliferation financing typologies. The Peddlars Peril Index is a good index to include in a financial institution's country risk model as this will provide a proliferation financing lens to country risk models which are usually more focussed on money laundering/terrorist financing.

Introducing proliferation financing within current money laundering/terrorist financing risk assessment should be proportionate, given the overall proliferation risk associated with the activities undertaken by the institution. A bank operating and transacting internationally for it's will require an assessment of a wider range of risks, including proliferation risks, compared to a smaller domestically focused institutions. Proliferation financing risk assessments should, similar to that of money laundering and terrorist financing risk assessment, consider the following:

- Geographic considerations (customers and trade partners)
- Customer characteristics
  - Political Exposure
  - Adverse Media
- Products used by customers
- Business activity (actual vs what is understood)
- Screening – screening the relevant parties of a customer and trade partner

Key considerations when conducting a proliferation financing risk assessment

Proliferators often use front persons and front companies to carry out their financial activities. Entities. Sanctions screening alone will not help as proliferators have been known to make use of foreign nationals, or nationals who hold dual citizenship in another country, to facilitate financial activities and are likely not to be on lists screened against.

Proliferation financing tends to be directed by state actors, who develop their own networks and distinctive ways of accessing the formal financial system. Proliferation networks employed by North Korea look very different to those employed by Iran.

North Korean Financial Institutions are not permitted to operate branches or representative offices outside of North Korea. They are known to use networks in Hong Kong, China, Malaysia and Singapore.

Proliferation financing is a very distinct financial crime risk as it is committed in the main by state actors. Money Laundering and Terrorist Financing controls will assist, but alone, they are not sufficient.

Understand how to screen for and identify dual use goods. There are challenges with this which need to be overcome. Consider the extent of your trade financing risk. Know which of your customers trade or are involved in the manufacture of controlled goods.

Finally, assess your current ML/TF controls and make the necessary adjustments to include proliferation financing control. This may only require small tweaks, but will provide increased protection. This will go a long way to supporting the country's efforts in the fight against proliferation financing.

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