

Proliferation Finance: Countering by design; taking sufficient steps within a Global Banking System



Written by James Emin

WHITE PAPER

London:
6th Floor
125 Old Broad Street
London, EC2N 1AR,
United Kingdom

New York:
19 W34th Street,
Suite 1018,
New York, NY 10001,
USA

Frankfurt:
1st Floor, Ander Welle 4,
Frankfurt am Main
60322,
Germany

Edinburgh:
9-10 St. Andrew Square,
Edinburgh,
EH2 2AF,
United Kingdom

Dublin:
Ground Floor,
One Georges Quay
Plaza,
Dublin 2, Eire

Paris:
Club Buro Vendome,
5 Rue de Castiglion,
75001,
Paris, France

Tel: +44 845 658 0008

Tel: +1 646 828 8264

Tel: +49 69 75938410

Tel: +44 131 281 2131

Tel: +353 1 9073297

Tel: +331 5345 1063

For more information please contact us at: info@lysisfinancial.com

WHAT IS PROLIFERATION FINANCE?

Proliferation Finance abuses the formal (supervised) global financial system to facilitate and deceive the transfer of value in the pursuit of procuring and moving the components to build, test and deliver weapons of mass destruction. These components are also known as dual use items which are heavily supervised under export control. Secondly, it impacts financial services market as proliferators rely on the formal financial system to act as a high level credible conduit to transfer value in the exchange for these dual use items and their transshipment. Therefore, FS firms are obligated to prevent, detect, investigate and report any activity that they suspect puts their organisation at risk to this abuse.

CURRENT AND FUTURE STATE OF GLOBAL AFFAIRS

A continued and very present priority for the international community is countering Proliferation Finance (PF) in all its forms. Back in 21 / 22 July 2018 in Buenos Aires, (*outgoing*) FATF President Sanitation Otamendi (Argentina) hosted a summit of the G20's Finance Ministers and Central Bank Governors. High up on the agenda was the prioritisation to enhance and work on preventing the financing of the Proliferation of weapons of mass destruction. There was support for revisions to develop and consider detailed proposals for amendments within the framework of FATF and current UN mandates.

Iran

With the continued erosion of The Joint Comprehensive Plan of Action and Iran's threat to enrich uranium to a higher level if Europe cannot shield Tehran from U.S. sanctions. Even though Europe has taken steps in the creation of a limited trade mechanism intended to make it possible for countries to go on trading with Iran outside the scope of the U.S. sanctions. But the mechanism is yet to be operational.

North Korea

The bilateral talks in Singapore between the US and DPRK may have seemed promising, however given their breakdown without resolution in Hanoi this has proven again that this is no grounds for complacency, talks will continue, but are still embryonic with concessions still being ironed out.

Former FATF President Marshall Billingslea (United States) chaired his first Plenary (19 October 2018). A major strategic initiative for FATF was the start of a project considering whether to expand its Recommendations applicable to Proliferation financing, enhancing implementation of existing obligations and developing best practices to counter Proliferation financing. Whilst the hereinabove is primarily to explore deficiencies and to help countries strengthen implementation of the existing FATF requirements, the principles for FATF's recommendation 7 remain in force. Financial institutions have a continued and vital role to play in ensuring the disruption of Proliferation procurement by detecting, impeding and reporting the illicit flow of funds in line with UNSCR1540. This should go beyond their firm's operation and cover the formal global financial system as a whole.

By taking sufficient steps in understanding who they do business with and who they facilitate transactions for; taking a holistic view of all counterparty's networks and supply chains. Therefore, be proactive in assessing current future threats and trends that is essential to countering by design.

FORGING A CONTROLLED ENVIRONMENT FRAMEWORK

One method to achieve countering by design is forging a controlled environment by setting out and developing control objectives specific to Proliferation Financing. This could serve as an effective risk and control framework demonstrating to regulators adequate oversight and monitoring measures.

Approach: Extensive research would be to carry out threat analysis and depict risks relevant to Proliferation Financing.

- A thorough assessment of the tactics used by proliferators to transfer funds or move assets in the pursuit of procuring dual use items
- Once all risks have been fully determined mitigates will have to be considered, that are relevant, proportionate and importantly effective
- These mitigates will act as a baseline to forming broader control objectives that need applying within relevant areas, with prior consultation
- Categorize and map control objectives to specific products of the global operating model, going beyond the traditional PF’s sensitive risk areas
- Once control objectives have been agreed and sign off by product and service owners, a compliance rating should be benchmarked
- This should not be perceived as weakness, but be championed as positive steps in understanding exposure and as a method to identify and plug gaps



CHALLENGES, CONCERNS AND CONSTRAINTS

Brexit and EU developments

EU:

The EU intends to update the current EU regime for the control of exports, transfer, brokering, technical assistance and transit of dual-use items.

Objective is to further strengthen the non-proliferation of weapons of mass destruction and their means of delivery, regional peace, security and stability as well as respect for human rights and international humanitarian law.

The new framework will introduce a number of changes to the EU export control system of dual-use items to adapt it to the changing technological, economic and political circumstances. They will also simplify and improve the current rules and optimise the EU licensing framework.

In particular, new provisions include:

- further **harmonising licensing processes**, through the introduction of new general export authorisations (EU GEAs), which are authorisations for exports to certain countries of destination available to all exporters who respect the conditions;
- harmonisation of **the control of supplying the technical assistance** related to sensitive items
- a new mention of **cyber surveillance items** highlighting that the competent authorities have the possibility to control such items using the current regulation as for all non-listed dual-use items that could be used for directing or committing serious violation of human rights.

Source: [European Council / Council of the European Union](#)

Brexit:

Regulation (EC) No 428/2009 setting up a Community regime for the control of exports, transfer, brokering and transit of dual-use items⁴ (the "Regulation") will no longer apply to the United Kingdom. With the UK's departure from the EU looking ever more likely, UK could take a unilateral response, to which may see its gradual divergence from the EU's harmonized dual use list. Whether or not HM Export Control Joint Unit (UK) takes this course of action remains to be seen.

The UK will be deemed a 3rd country that is a party to relevant international treaties and a member of international non-proliferation regimes and applies proportionate and adequate controls. As of the withdrawal date, export licenses issued by the United Kingdom as an EU Member State under the Regulation are no longer valid for exports of dual-use items from the EU-27 to third countries. Rather, such exports of dual-use items from the EU-27 to third countries are going to require, as of the withdrawal date, a license issued by a competent authority of one of the EU-27 Member States, in accordance with Article 9 of the Regulation.

According to Article 22 of the Regulation, certain very sensitive dual-use items, listed in Annex IV to the Regulation, are subject to intra-EU transfer controls. As of the withdrawal date, the export of these items will be subject to authorisation under the terms and conditions of the Regulation. However, intra-EU transfer licences issued by one of the EU27 Member States for transfers to the United Kingdom issued before the withdrawal date should be considered as valid licences for exports to the United Kingdom as of the withdrawal date, and until the validity of the licence expires

Source: [European Council / Council of the European Union](#)

GDPR: Depending or not if there is a hard Brexit could see the UK as a 3rd country and possible cause data sharing constraints of transactional data, though given the ICO's full adoption of the General Data Protection Regulation and the UK's provisions of rigorous data control- this seems less likely.

Asset freezing: OFACs prompt and covert (intelligence led) unilateral action on proliferator's takes effect to near enough real-time, feeding from the department of treasury to banking systems Watch List Filters. Multilateral UN sanctions, however, take time to ratify and embed. This timely implementation process to cascade to all UN member's states central banks and treasury departments could allow proliferators to evert justice and move assets prior to full implementation. It is therefore cognizant to screen against OFAC irrespective of being out US products scope and enforcement jurisdiction.

Cryptocurrency: The procurement of dual good items in the pursuit to of mass destruction capabilities heavily rely on the Financial system to ensure an effective supply chain, thus demonstrating credibility to legitimate and compliant (export control) suppliers. This has negated concerns of the use of crypto assets to facilitate Proliferation from some competent authorities; primarily UK FCAs [Cryptoassets Taskforce](#)

CONCLUSION

Once remedial work has been executed, continued and concerted efforts should not stop there. Proliferators are predominantly state sponsored actors. They have the resources, capacity, intelligence agencies – plus expertise of a government to their disposal. A continuous improvements cycle of incremental change, to counter these new and emerging tactics should be considered; ideal using the agile methodology. Given that letters of credit only account for a small proportion of trade finance, FIs should go beyond reasonable steps of traditional AML methods of; screening, ID&V CDD and trade finance monitoring with sufficient steps. Rules based approaches are often binary and vulnerable to circumvention. Therefore, a risk based approach should be applied.

All participants need to be vigilant actors through the process of training and awareness of front line personnel. As the threat is there and it is very real; given the success of the AQ Khan network and what it has ultimately achieved. Proliferators often adopt the transaction (credit) risk and use 'open account' transactions and use unscrupulous brokers, shipping agents and opaque shelf and shell companies. This in turns limits the amounts of information FIs are privy to, in facilitating possible illicit transactions. While many dual use goods manufacturers and suppliers have internal compliance, they can also be unwitting actors to proliferator's methods to disguise intent and destination. FIs demonstrating rigor to understand the purpose of 'at risk transactions', will not only appease the competent authorities, but will act as deterrent to sophisticated proliferators and contribute to a firm's global reputation of sound integrity.

Written by: James Emin (<https://www.linkedin.com/in/james-emin-3688985b/>)

Contact: info@lysisfinancial.com

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