

What is proliferation financing?

The proliferation of weapons of mass destruction (WMDs) poses serious threats to human life, the environment, infrastructure and, more broadly, to international peace and security. Both state and non-state actors, such as terrorist groups, pose proliferation threats. Countering the flow of funds to proliferation actors plays a vital role in combating the proliferation of WMDs.

There is no international definition of 'proliferation financing'. International obligations to combat the financing of proliferation are primarily contained in United Nations Security Council Resolution (UNSCR) 1540 which calls on states to use criminal, civil or administrative measures to combat the proliferation of WMDs by non-state actors, and UNSCRs imposing sanctions on Iran and North Korea as state proliferation actors. Together, these UNSCRs contain a broad range of what may be described as financial measures to combat proliferation of WMDs. Proliferation financing can therefore be described as both a financial crime risk and a sanctions risk.¹

Targeted financial sanctions are one component of a range of UNSCR measures to counter the flow of funds to proliferation actors. The Financial Action Task Force² (FATF) sets standards for implementing targeted financial sanctions against Iran and North Korea to combat their nuclear proliferation programs. FATF Recommendation 7 and Immediate Outcome 11 outline international standards for effectively implementing targeted financial sanctions related to proliferation.

The FATF also produced a working definition of proliferation financing based on UNSCR 1540 as follows:

*"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.*³

To find information on the full range of sanctions measures, particularly against North Korea, you should consult the United Nations Sanctions website at:

<https://www.un.org/securitycouncil/sanctions/information>

The full range of UN sanctions measures go beyond targeted financial sanctions to also include activity-based financial prohibitions, economic or sectoral sanctions and related financial prohibitions, and vigilance measures.

Two other useful resources are listed below, both of which contain quick reference lists and descriptions of the full range of UNSCR sanctions obligations.

¹Joshi, Dall, Dolzikova, *Guide to Conducting a National Proliferation Financing Risk Assessment*, RUSI Occasional Papers, May 2019, p.5.

²The Financial Action Task Force is an inter-governmental body that sets standards on anti-money laundering, counter- terrorism financing and counter-proliferation financing.

³FATF, *Combating Proliferation Financing: A Status Report on Policy Development and Consultation*, 2010.

- FATF *Guidance on Counter Proliferation Financing: The Implementation of Financial Provisions of United Nations Security Council Resolutions to Counter the Proliferation of Weapons of Mass Destruction* (2018):

<http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-Countering-Proliferation-Financing.pdf>

- Anagha Joshi, *Supplementary Material for Guidance Paper: Model Provisions to Combat the Financing of the Proliferation of Weapons of Mass Destruction*, RUSI, Second Edition (2018):

https://rusi.org/sites/default/files/20181002_model_law_2nd_edition_final_for_web.pdf

Proliferation financing methods and their comparison to money laundering and terrorism financing

Money laundering is a circular process, whereby criminally generated funds are laundered to make them available again for use in licit form. While proliferation financiers may use money laundering techniques to move funds through the financial system, the process of proliferation financing is linear. In this way, it is similar to terrorism financing. Proliferation financiers move funds through stages and use them to pay for goods and services required for proliferation of WMDs.⁴

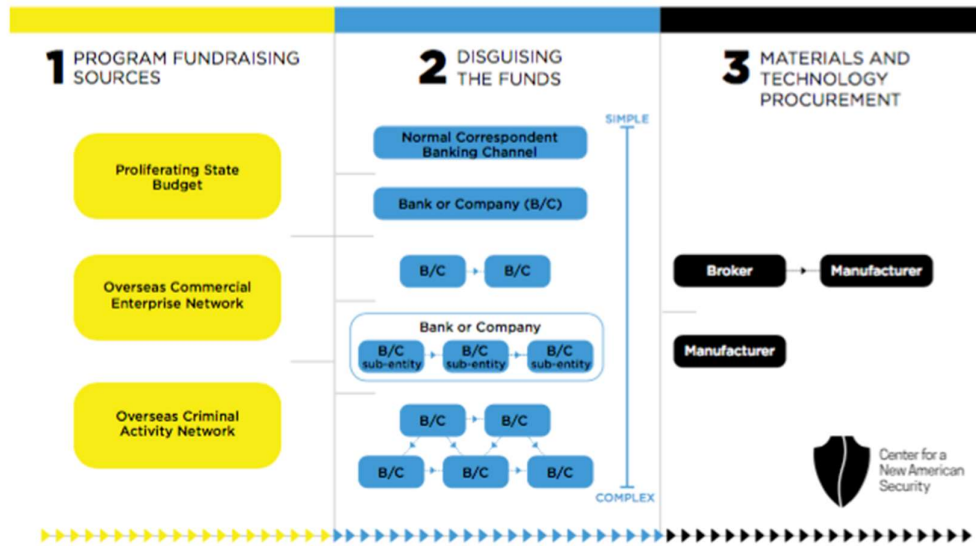
A report by CNAS described the three stages of proliferation financing as:

1. program fundraising activities
2. disguising the funds as they move through the international financial system, and
3. procurement of materials and technology within the international financial system.⁵

⁴Dr Jonathan Brewer, *The Financing of Nuclear and Other Weapons of Mass Destruction Proliferation*, CNAS, January 2018, pp.4-5.

⁵ Dr Jonathan Brewer, *The Financing of Nuclear and Other Weapons of Mass Destruction Proliferation*, CNAS, January 2018, p.4.

Figure 1. Three stages of FoP



Source: Dr Jonathan Brewer, *The Financing of Nuclear and Other Weapons of Mass Destruction Proliferation*, CNAS, January 2018, p.5.

A report by RUSI further broke proliferation financing into three categories of activities:⁶

1. Financial products and services related to trade in proliferation sensitive goods

This includes funds and payments to procure proliferation-sensitive goods and financial services supporting the trade in proliferation-sensitive goods (import/export of goods as well as transport of goods). For example, trade finance products, maritime or cargo insurance and export guarantees.

2. Revenue raising activities

This includes illicit activities, such as:



⁶Joshi, Dall, Dolzikova, *Guide to Conducting a National Proliferation Financing Risk Assessment*, RUSI Occasional Papers, May 2019.

It can also include licit profit-making activities where the proceeds are diverted to support proliferation of WMDs. For example:



3. Corporate or financial infrastructure that supports the above two activities

This category reflects the complex networks that are developed by proliferation actors, particularly North Korea, to facilitate its activities in the above two categories. This category of activities includes the establishment of joint ventures or front companies, the provision of remittances services (for example by companies not licensed as remitters), and cross-border transportation mules. Proliferation financing may not be the sole or predominant purpose of the corporate activities and products may also be unwittingly used.

For further typologies or case studies of proliferation financing, you should consult the resources below.

- United Nations Panel of Experts Reports related to North Korea which contain detailed case studies:

https://www.un.org/securitycouncil/sanctions/1718/panel_experts/reports

- Jonathan Brewer, *Final Report on the Study of Typologies of Financing of WMD Proliferation*, King's College London (2017), which contains a broad range of typologies or case studies including those related to North Korea, Iran, Syria and others:

<https://projectalpha.eu/wp-content/uploads/sites/21/2018/05/FoP-13-October-2017-Final.pdf>

- FATF, *Proliferation Financing Report*, June 2008t:

<http://www.fatf-gafi.org/media/fatf/documents/reports/Typologies%20Report%20on%20Proliferation%20Financing.pdf>

Proliferation financing risks

A country may be exposed to proliferation financing risks in different ways, including:

- Whether they host a major financial centre, and are thus more likely to be involved in illicit financial flows
- Whether they have a major transshipment centre in their territory

- Whether they are home to a manufacturing sector that produces goods controlled by international supplier regimes related to WMD and their delivery vehicles⁷
- Whether they are geographically close to a proliferating country
- Whether a proliferating state has diplomatic presence in the country
- Whether a proliferating state has significant corporate and trade networks in the country
- Whether the country offers shipping flags of convenience or passports of convenience, which proliferators have been known to exploit.⁸

The financial sector's exposure to proliferation financing risks should be explored by considering the above factors through a further analysis of:

- The jurisdictions involved
- The types of customers and the customer's business
- The products and services offered
- The channels through which those products and services are delivered.⁹

For further information on conducting risk assessments, you should consult the resources below. The FATF Guidance provides general information for developing risk assessment methodologies. The RUSI Guide provides information and tools for proliferation financing-specific risk assessment methodologies. It is primarily aimed at governments, but also includes a sectoral risk assessment tool that would be useful for the financial sector. The CNAS paper is primarily aimed at financial institutions.

- FATF Guidance, National Money Laundering and Terrorist Financing Risk Assessment, February 2013:

https://www.fatf-gafi.org/media/fatf/content/images/National_ML_TF_Risk_Assessment.pdf

- Joshi, Dall, Dolzikova, *Guide to Conducting a National Proliferation Financing Risk Assessment*, RUSI Occasional Papers, May 2019:

https://rusi.org/sites/default/files/20190513_guide_to_conducting_a_national_proliferation_financing_risk_assessment_web.pdf

- Dr Jonathan Brewer, *The Financing of WMD Proliferation: Conducting Risk Assessments*, CNAS, November 2018:

<https://s3.amazonaws.com/files.cnas.org/documents/CNASReport-FoPRiskAssessment-FINAL-min.pdf?mtime=20181030125029>
FATF proliferation financing 'red flag' indicators¹⁰

⁷These are the Nuclear Suppliers Group, the Missile Technology Control Regime, and the Australia Group.

⁸Berger, Joshi, *Countering Proliferation Finance: Implementation Guide and Model Law for Governments*, RUSI Guidance Paper, July 2017, pp.9-10.

⁹Joshi, Dall, Dolzikova, *Guide to Conducting a National Proliferation Financing Risk Assessment*, RUSI Occasional Papers, May 2019, Annex 6 RUSI Proliferation Financing Rapid Risk Assessment Tool.

¹⁰FATF, *Proliferation Financing Report*, June 2008, Annex 1. Report is available at: <http://www.fatf-gafi.org/media/fatf/documents/reports/Typologies%20Report%20on%20Proliferation%20Financing.pdf>

- Transaction involves individual or entity in foreign country of proliferation concern.
- Transaction involves individual or entity in foreign country of diversion concern.
- Trade finance transaction involves shipment route (if available) through country with weak export control laws or weak enforcement of export control laws.
- Transaction involves individuals or companies (particularly trading companies) located in countries with weak export control laws or weak enforcement of export control laws.
- Transaction involves shipment of goods inconsistent with normal geographic trade patterns (e.g. does the country involved normally export/import good involved?).
- Transaction involves shipment of goods incompatible with the technical level of the country to which it is being shipped, (e.g. semiconductor manufacturing equipment being shipped to a country that has no electronics industry).
- Transaction involves financial institutions with known deficiencies in AML/CFT controls and/or domiciled in countries with weak export control laws or weak enforcement of export control laws.
- Based on the documentation obtained in the transaction, the declared value of the shipment was obviously under-valued vis-à-vis the shipping cost.
- Inconsistencies in information contained in trade documents and financial flows, such as names, companies, addresses, final destination etc.
- Customer activity does not match business profile, or end-user information does not match end-user's business profile.
- Order for goods is placed by firms or individuals from foreign countries other than the country of the stated end user.
- Customer vague/incomplete on information it provides, resistant to providing additional information when queried.
- New customer requests letter of credit transaction awaiting approval of new account.
- The customer or counterparty or its address is similar to one of the parties found on publicly available lists of "denied persons" or has a history of export control contraventions.
- Circuitous route of shipment (if available) and/or circuitous route of financial transaction.
- Transaction demonstrates links between representatives of companies exchanging goods i.e. same owners or management.
- Transaction involves possible shell companies (e.g. companies do not have a high level of capitalization or displays other shell company indicators).
- A freight forwarding firm is listed as the product's final destination.
- Wire instructions or payment from or due to parties not identified on the original letter of credit or other documentation.
- Pattern of wire transfer activity that shows unusual patterns or has no apparent purpose.

Actions to mitigate proliferation financing risks

Guidance on enhancing compliance with targeted financial sanctions, including those related to proliferation financing, can be found on the FIU website: www.mongolbank.mn/TFS-Guidance

For a more comprehensive approach to mitigating proliferation financing risks more broadly, counter-proliferation financing considerations should be included in:

- Employee training programmes
- Client and business risk assessments
- Compliance programmes with senior management oversight
- Know Your Customer procedures
- Transaction monitoring programmes
- Reporting procedures

You should consult all available open-sources regularly (e.g. UN Panel of Experts Reports).

You should engage with authorities regularly: Financial Information Unit (e-mail: fiu@mongolbank.mn), General Intelligence Agency (e-mail: amltf@gia.gov.mn)

Understand your geographic and activity exposure to proliferation financing risks

- Consider the importance of local market to international financial services.
- Evaluate relation/proximity to proliferator threat.
- Understand and assess own business exposure.
- Assess exposure to key trading hubs (strength of export/customs controls) and trade finance.

Know Your Customer

- New and existing clients should be proliferation financing risk-assessed.
 - Include proliferation financing-specific questions in due diligence evaluations. Typical anti-money laundering and counter-terrorism financing procedures may not always be relevant.
 - Note any involvement in WMD technology supply chains.
 - Identify if any export control regulations apply.
 - Assess any deviation in client activity from 'business as usual'.
- Assess due diligence practices of clients working with sensitive goods.
- Assess client geographic activity and relations. Note that links may not be direct.

Identify proliferation financing sensitive goods and activities

- Ensure trade finance is integrated into compliance procedures.
- Identify final destinations of goods and finances.
- Draw on export-control regime lists, and any other industry/component lists.
- Engage in partnerships with other relevant industries (insurance/shipping).

Key United Nations Security Council Resolutions on proliferation financing

United Nations Security Council Resolution on non-proliferation

Resolution 1540 (2004) of the Security Council, adopted on 28 April 2004
Successor resolutions to the above Resolution

United Nations Security Council Resolutions on Democratic People's Republic of Korea

Resolution 1718 (2006) of the Security Council, adopted on 14 October 2006
Resolution 1874 (2009) of the Security Council, adopted on 12 June 2009
Resolution 2087 (2013) of the Security Council, adopted on 22 January 2013

Resolution 2094 (2013) of the Security Council, adopted on 7 March 2013
Resolution 2270 (2016) of the Security Council, adopted on 2 March 2016
Resolution 2321 (2016) of the Security Council, adopted on 30 November 2016
Resolution 2371 (2017) of the Security Council, adopted on 5 August 2017
Resolution 2375 (2017) of the Security Council, adopted on 11 September 2017
Resolution 2397 (2017) of the Security Council, adopted on 22 December 2017
Successor resolutions to the above Resolutions

United Nations Security Council Resolutions on Iran

Resolution 2231 (2015) of the Security Council, adopted on 20 July 2015