



UNDERSTANDING PROLIFERATION FINANCE NATIONAL RISK ASSESSMENTS

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ABSTRACT

The renewed interest in assessing the risks associated with the financial support to WMD proliferation activities, spurred by the amendment to FATF Recommendation 1, represents a pivotal moment to accelerate the paradigm shift from a rule-based to a risk-based approach. This article argues that, despite the challenges posed by the complexity of the matter and the production of the risk assessment, it is critical that national authorities and the private sector do not miss the opportunity of assessing the risk of proliferation finance more broadly, by not only focusing on compliance with the FATF standard. Although FATF Recommendation 1 focuses on UN targeted financial sanctions related to WMD proliferation, other risks of financing WMD programmes, including the violation of resolution 1540 (2004), should not be overlooked.



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In October 2020, the Financial Action Task Force's¹ (FATF) Recommendation 1 and its Interpretative Note were amended to extend the obligation of performing risk assessments on money laundering and terrorism financing to proliferation financing (PF). Countries and the private sector were requested to identify, assess,

and understand proliferation financing risk and to adopt commensurate measures to mitigate it. While Recommendation 1 only requires covering the risk of breach, non-implementation or evasion of the targeted financial sanctions (TFS) adopted by the United Nations Security Council (UNSC) against listed entities

and individuals involved in specific weapons of mass destruction (WMD) and ballistic programmes, FATF also encourages countries to look beyond the required scope.²

When FATF began to explore measures to counter WMD proliferation finance, it focused on the implementation of the obli-

1 The Financial Action Task Force is the intergovernmental body tasked with defining standards to protect the international financial system from illicit financial activities including money laundering, terrorist financing and proliferation financing.

2 "An understanding of the risk of WMD proliferation and its underlying financing, which is not required under the FATF Standards, may positively contribute to the understanding of the risk of the breach, non-implementation or evasion of PF-TFS (i.e. the narrow definition of PF risks covered in the FATF Standards)." Financial Action Task Force, *Guidance on Proliferation Financing and Risk Assessment and Mitigation*, Paris, France, June 2021, p. 8.



© FATF - The amendment to FATF's Recommendation 1 obliges countries to perform risk assessments for proliferation financing

gations stemming from UNSC resolution 1540 (2004). More precisely, the assessment of the proliferation finance threat was primarily associated to the risk of providing “financial services for the transfer and export of nuclear, chemical or biological weapons; their means of delivery and related materials.” In particular, it involved “the financing of trade in proliferation sensitive goods, but could also include other financial support to individuals or entities engaged in proliferation.”³

The sophistication and mutability of the risk of WMD proliferators exploiting jurisdictions’ financial systems or resour-

ces have urged the transition from a rule-based approach – clear but inflexible– to a risk-based approach –complex but adaptive–. Flexibility has become necessary to respond to the evolving PF schemes and tactics adopted by WMD proliferators, whether listed individuals or entities, related networks or any State or non-State actor with malign intentions.

KNOW THYSELF

The amendment to FATF Recommendation 1 marked a watershed in counter-proliferation financing (CPF), because it acknowledged the complexity of this illicit

financial activity and required jurisdictions to become fully aware of their exposure to PF. In other words, the risk-based approach requires countries to go beyond compliance with its prescriptive and precise rules. The purpose of this novel approach is to mitigate the risks by effectively allocating the limited resources available: the higher the risk, the greater the resources; the lower the risk, the greater its tolerance.

The national risk assessment (NRA) is an inward-looking exercise involving the identification of PF actors and networks, also referred to as threats, and the country’s weaknesses or contextual

³ Financial Action Task Force, *Proliferation Financing Report*, Paris, France, June 2008, p. 3.

factors, also referred to as vulnerabilities. Once threats and vulnerabilities are identified, the authorities should assess the likelihood of the former exploiting the latter and the consequences that these events could generate in the event of the advancement of WMD programmes. Based on the NRA findings, the authorities prioritize the risks and decide which risk management strategy to implement.

The NRA is a self-awareness path, where the members of the working group⁴ representing different agencies become familiar with PF-related matters, investigate the set of data they own and analysing relevant qualitative and quantitative information. Each element contributes to the formation of a mosaic depicting possible scenarios, which define the risk. This research is key to build the country's understanding of the potential sources of the risks and of the aspects to improve in the national counter-proliferation financing (CPF) regime, such as the level of awareness and the preventive measures the exposed economic sectors should adopt.

CHALLENGES

Understandably, the completion of a PF national risk assessment gives rise to different challenges. A first challenge is the perception of the PF risk. Since there may be limited knowledge among authorities on the multifaceted nature of proliferation finance, despite its potentially high impact, it is often perceived as a low probability risk. Therefore, PF-NRAs have historically struggled to acquire top positions in decision-makers' agenda.

While FATF's amendment of Recommendation 1 partially changed this perception by making the PF-NRA an international standard, the requirement is still only limited to a narrow definition of PF, sometimes leading to PF-NRAs that are limited in scope. In fact, the risk of financing the proliferation of weapons of mass destruction is far-reaching: it stems not only from individuals and entities listed in UN sanctions lists (and their respective networks), but also from any other potential proliferator, whether a non-State actor or a country of proliferation concern. Understanding

this complexity is critical to protect national security and the financial system.

A second challenge is PF awareness. The agencies asked to participate in a PF-NRA working group may be not familiar with proliferation finance if their activities are only tangentially or indirectly affected by the PF risk. Nonetheless, the importance of each agency's contribution to the mosaic is crucial to piece together PF networks and their schemes, given that a holistic approach is needed to understand a country's exposure to PF risks. Hence, the authorities in charge of coordinating the drafting process should ensure that all members of the working group are trained and ready to analyse and discuss the findings of their respective investigations.

A third challenge, from the perspective of resource allocation, is represented by the time and the efforts required to produce the PF-NRA document. The data collection and analysis do not occur overnight. Research, questionnaires, interviews and evaluations are necessary to

⁴ The leading agency should involve in the PF-NRA those authorities involved in the national CPF institutional framework as listed in the 2018 FATF Guidance on Counter Proliferation Financing (e.g. policy departments, supervisory authority, customs, export control agencies, law enforcement and prosecution, financial intelligence units, intelligence services) as well as consult their respective industry stakeholders.

produce reliable outcomes, generally further vetted by the national authorities tasked with coordination. Moreover, the actual drafting can be time-consuming, as the editors must translate and synthesize the often complex quantitative and qualitative data into a document that is accessible to readers. Thus, the first PF-NRA process should be carefully planned and budgeted to guarantee rapid and valuable results. PF-NRAs must be updated regularly, however subsequent versions usually take less time and are less resource-intensive.

LIMITATIONS

While national risk assessments are pivotal preventive measures for the protection of the international financial system, there are a few limitations to consider. First, the assessment procedure for PF risks is not standardized. The differences in scope of each country's PF-NRA, as well as the different criteria used to assess each country's exposure, do not allow for a comparison between them. While one country may decide to

focus on the risks of breach, non-implementation or evasion of the UN targeted financial sanctions, another may adopt a broader scope, including, for example, the provision of financial services to trade-related proliferation or revenue-generating tactics aimed at providing financial support to WMD proliferation programmes.

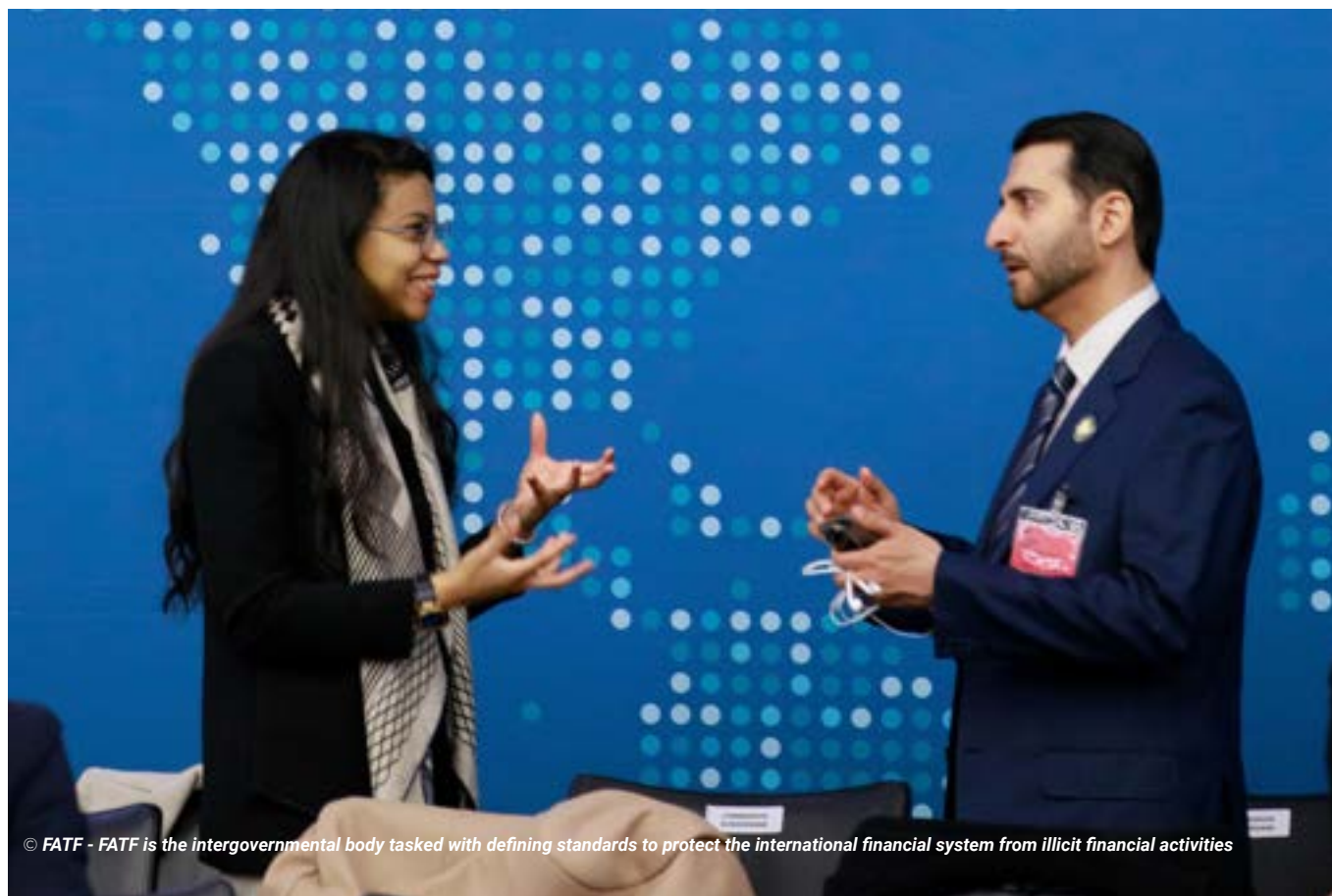
Moreover, PF-NRAs may appear subjective in some respects. However reasonable and balanced, the criteria for the assessment and the risk measurement system are not agreed upon at international level, but rather defined by the authors. Therefore, the same PF risk determined by similar conditions may be evaluated, for instance, as low in one PF-NRA and medium in another. Finally, since proliferation financing sits at the intersection between finance and security, certain data arising from agencies' investigations are sensitive and cannot be disclosed. Therefore, national authorities may decide to draft two versions of the document: a confidential version for internal use only and a second one to release.

ASSESS TO ADDRESS

Nonetheless, the above-mentioned limitations are dwarfed by the positive effects of conducting a PF national risk assessment. The document represents a critical achievement in the enhancement of the national counter-proliferation financing regime, both in terms of the process and of the product. Identifying PF actors and tactics and how the country is exposed to them lays the foundations for an effective CPF strategy encompassing a multiagency response, coordination between government and the private sector and possibly bilateral and multilateral cooperation at international level. Among the immediate results, it is worth highlighting that the establishment of a working group for the drafting of the PF-NRA is, in itself, a welcome defeat of silo-based approaches in line with the CPF inter-agency mechanism requested in FATF Recommendation 2.⁵

Further, the PF-NRA provides invaluable guidance to the private sector for conducting institutional risk assessments.

⁵ Pursuant to FATF Recommendation 2, competent authorities should have co-operation, coordination and information sharing mechanisms to combat the financing of proliferation of weapons of mass destruction.



The NRA defines the framework in which businesses and professionals operate while providing directions on the threats and the vulnerabilities to consider in institutional risk assessments. Consequently, financial institutions and the private sector at large, as the first line of defence, are enabled to internalize the PF risk in their daily activities through policies and procedures. Concurrently, institutional risk assessments support national authorities to build reliable PF-NRAs. Increased security and resource optimization are the corollary to such process.

Finally, by sharing information and PF cases, countries build trust and pave the way to global cooperation in countering proliferation finance. Cases represent the greatest contribution to the fight against this transnational financial crime, as they illustrate the characteristics and the evolution of the PF networks and of their tactics. Case collection helps develop PF typologies, which, in turn, help to identify the risk indicators, or red flags, that operators consider when assessing clients or transactions.

In conclusion, while FATF Recommendation 1 on PF-NRA currently only covers the risk of breach, non-implementation and evasion of relevant UN targeted financial sanctions, countries should address the risk of proliferation finance in broader terms. Despite the challenges posed by their complexity, NRAs should assess proliferation finance risks more comprehensively, including the core meaning of PF stemming from UNSCR 1540 (2004), in light of the greater benefits to national and international security.