



**GUIDANCE NOTE ON PROLIFERATION AND PROLIFERATION
FINANCING:
NON BANK FINANCIAL INSTITUTIONS**

January 2020

AML/CFT&P Guidance Note No. 1 of 2020

✓

The United Nations Security Council (UNSC) has, over the past few decades, adopted many resolutions to protect the international community from the proliferation of weapons of mass destruction, which are a serious threat to international peace and security. There is need for all countries, including Eastern and Southern African countries, to understand and apply the international sanctions regime and to take necessary steps to prevent sanctions violations as part of their obligations under the relevant United Nations Security Council Resolutions (UNSCRs).

Recommendation 7 of the Financial Action Task Force (“FATF”) requires countries to implement targeted financial sanctions to comply with the UN Security Council Resolutions relating to the prevention, suppression and disruption of proliferation of weapons of mass destruction and the financing thereof.

Targeted financial sanctions relating to proliferation financing are applicable to persons and/or entities designated by the UN Security Council or the relevant committees set up by the Security Council.

It is required that, countries freeze immediately, the funds, other financial assets and economic resources within their jurisdictions, at the time of the adoption of the resolution or at any time thereafter, that are owned and/or controlled directly or indirectly by the designated persons/entities. Countries are further required to ensure that no funds and or any other assets and economic resources are made available to such persons except under specific situations and conditions stipulated in the UNSC resolutions.

1. PURPOSE

This guidance note has been issued by the Non-Bank Financial Institutions Regulatory Authority (“NBFIRA”) to raise awareness of the risks and vulnerabilities with regards to *proliferation* and *proliferation financing*, as well as the potential effect on Botswana’s financial system if a non-bank financial institution, (referred to as a specified parties in the Financial Intelligence Act of 2019) knowingly or unknowingly plays an appreciable role in proliferation financing.

The country has not encountered any direct acts of terrorism or proliferation through the use of any institution under the supervisory purview of NBFIRA, meaning that to date, this threat is uncommon. However, instances of proliferation financing are still possible due to size of the non-bank sector, complexity of transactions conducted due to diversity of products offered, distribution channels and a wide range of consumers. In other words, given the potential for human and social catastrophe associated with proliferation, even a low probability risk of proliferation and proliferation financing must not be taken lightly.

2. SCOPE

This Guidance Note should be read in conjunction with the Financial Intelligence Act of 2019 (“FI Act”) and the Financial Intelligence Act of 2019 Regulations 2019 (“FI Act regulations”), international standards and other guidelines provided by competent authorities.

3. APPLICABILITY

This guidance note is applicable to all persons and entities regulated and supervised (Non-Bank Financial Institutions (“NBFIs”) by the NBFIRA

After reading this guidance note and considering the specified parties’ own business practices and possible exposure to the risks, NBFIs may wish to consider measures such as –

- improved staff training;
- implementation of new policies and procedures or adaptation of existing ones;
- undertaking risk assessments;
- risk assessments, of clients, customers, suppliers, end-users and third parties involved in particular areas of their business; and
- employing enhanced due diligence procedures to any higher-risk transactions or entities.

4. WHAT IS PROLIFERATION?

The FI Act defines proliferation as the manufacture, acquisition, possession, development, export, transshipment, brokering, transport, transfer, stockpiling or use of any arms of war or NBC weapons in contravention of the Arms and Ammunition Act, Nuclear Weapons Act or Chemical Weapons (Prohibition) Act;

5. WHAT IS PROLIFERATION FINANCING?

It can thus be inferred from the foregoing section that proliferation financing is 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, 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.

6. WHY IS THE PREVENTION AND DETECTION OF PROLIFERATION AND ITS FINANCING IMPORTANT?

Proliferation financing facilitates the movement and development of proliferation-sensitive goods. The movement and development of such items can contribute to global instability and may ultimately result in a loss of life, if proliferation-sensitive items are deployed.

7. HOW PROLIFERATORS OPERATE

Several typologies, some of which can be found on the FATF website, describe various characteristics attributed to proliferators, their operations and their networks. Below is a summarized extract of these qualities.

Proliferators tend to;

- a. Operate globally;
- b. Disguise their acquisitions as legitimate trade; and
- c. Exploit weaknesses global commerce controls (i.e. operate in countries with weak export controls or free trade zones where their procurements and shipments might escape scrutiny).

Proliferation Networks comprises proliferators who:

- a. Abuse both the formal and informal sectors of the international financial system by using the ordinary financial transactions to pay intermediaries and suppliers outside the network;
- b. use cash to trade in proliferation type goods to circumvent the system;
- c. purchase proliferation sensitive goods/services in the open market and make them appear legitimate to avoid suspicions of proliferation (i.e. purchase of dual use goods);
- d. conduct financial transactions through false intermediaries, front companies and illegal trade brokers; and
- e. create complex procurement networks to avoid detection of the true end users of proliferation sensitive goods

8. INDICATORS OF POSSIBLE PROLIFERATION FINANCING

An extract of the February 2018 FATF guidance on Counter proliferation financing (*Annex A*) is attached hereto containing an extensive list of situations that may indicate possible proliferation activities.

9. RISKS ASSOCIATED WITH PROLIFERATION FINANCING

An understanding of financing risks will positively contribute to the country's ability to prevent persons and entities involved in weapons of mass destruction, proliferation from raising, moving and using funds, and thus the implementation of targeted financial sanctions will in turn contribute to a stronger counter proliferation financing regime.

Amongst other relevant risk factors, during their risk assessments, NBFIs should consider the following associated indicators of increased potential proliferation risks:

9.1 Country/Geographic Risks

NBFIs must assess whether or not the client and or their business is located in a country that is subject to a relevant UN sanction (i.e. Democratic Republic of Korea or Iran) or is listed on any reputable international listing for high risk entities more especially where Botswana has international relations of mutual benefit (i.e. UK/EU Specially Targeted List or OFAC Listing). Additional factors to be considered are as follows;

- Countries with weak financial safeguards and which are actively engaged with a sanctioned country;

- The presence of an industry that produces dual use goods, proliferation sensitive items or military goods;
- Deliberate insertion of extra links into the supply chain;
- Countries that are known to have weak import/export control laws or poor enforcement; and
- Countries that do not have the required level of technical competence in regard to certain prohibited goods.

9.2 Customer Risk

- a. At the inception of a business relationship (i.e. onboarding) and ongoing due diligence processes, NBFIs must determine the type of business the client is engaged in to assess whether it poses potential proliferation risks.
- b. Assess whether the client's end user is associated with a listed Military or Research Company connected with a high-risk jurisdiction of proliferation concern.
- c. Some of the red flags to be considered are as follows;
 - The customer is involved in the supply, sale, delivery or purchase of dual use, proliferation sensitive or military goods, particularly to higher risk jurisdictions.
 - The customer or counter party, or its address, is the same or similar to that of an individual or entity found on publicly available sanctions lists.
 - The customer is a military or research body connected with a higher risk jurisdiction of proliferation concern.
 - The customer's activities do not match the business profile.
 - The customer is vague about the end user(s) and provides incomplete information or is resistant when requested to provide additional information.
 - The customer uses complicated structures to conceal involvement, for example, uses layered front companies, intermediaries and brokers.

9.3 Product/Service Risk

- a. NBFIs must determine if specific products/services offered by themselves could involve potential proliferation factors (i.e. delivery of financial services to clients from a country targeted on the FATF, EU or UN Sanctions Listing)
- b. Consider other variables specific to the customer or transaction such as:
 - Duration of relationship;
 - Purpose of relationship;
 - Corporate structure; and
 - Volume of the anticipated transaction(s).

10. MANAGEMENT OF PROLIFERATION FINANCING RISKS

Section 11 of the FI Act of 2019 obligate NBFIs to conduct risk assessments of *the risk of commission of financial offences and take appropriate measures to manage and mitigate the identified risks*. It is on the basis of their risk assessments that NBFIs can manage their potential proliferation financing risks by implementing a Risk Based Approach that incorporates controls to mitigate the risk of PF within their current AML/CFT structures.

This could be achieved through;

- a. Applying an objective criterion to assess the potential proliferation financing risk by using an NBFIs expertise and obtaining information from government agencies;
- b. Building on the NBFIs existing AML/CFT framework by incorporating proliferation risk factors for consideration along with the wider determination of risk factors;
- c. Using the NBFIs established AML/CFT mechanism to conduct risk assessments and identify suspicious activity that is applicable to proliferation considerations;
- d. Implementing risk based anti-proliferation and proliferation financing policies and procedures, comparable to international standards. Including training to identify suspicious activity and a system for reporting suspicious transactions; and
- e. Developing and maintaining in-house policies and procedures relative to countering proliferation and proliferation financing and compliance with these proliferation financing guidelines.

Introducing proliferation financing into an institution's current risk assessment practice should be proportionate to the overall proliferation risk of the activities currently undertaken by the institution. It is important that NBFIs adopt policies preventing client relationships that expose the NBFIs to countries, customers, and products that are higher risk for proliferation financing.

Additionally, the following risks should be considered when formulating a proliferation focused risk assessment:

Country or Geographic Risk: A strong indicator will be links to a country that is subject to sanctions against proliferation, an embargoed destination, or countries that have strong links with terrorist groups and activities.

Customer Risk: In particular, where a customer is involved in the supply, purchase or sale of dual use, proliferation sensitive or military goods. Also, customers who are on national lists concerning high risk entities and those connected to a higher-risk jurisdiction of proliferation concern.

Product and Service Risks: Project financing of sensitive industries in higher risk jurisdictions; higher risks may result where delivery of services is subject to sanctions; trade finance services, transactions and insurance products involving higher risk jurisdictions; and the delivery of high volumes of dual use, proliferation sensitive or military goods, particularly to a higher risk country.

Higher Risk Transactions and Entities: lists compiled by international authorities may assist an institution, by providing information on entities and individuals who may pose a proliferation concern.

Trade Finance and Insurance Products: can impose challenges and risks. (e.g. Enhanced due diligence should focus on direct loans or general credit facilities to facilitate export transactions; provision of guarantees on behalf of exporters; provision of insurance against certain risks in the trading process)

The FATF Working Group on Terrorist Financing and Money Laundering (WGTM)

The FATF's WGTM Project Team on Proliferation Financing suggests several measures which can be implemented by institutions to mitigate the risk posed by high risk customers. All specified parties should possess adequate policies and processes including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the institutions from being used, intentionally or unintentionally, for criminal activities. NBFIs are thus urged to have strong ML/FT risk management programs in place that incorporates the following:

- a. Customer and transaction screening, which includes, enhanced due diligence, increased monitoring, enhanced frequency relationship reviews and senior management approval;
- b. Account monitoring, with the use of automatic systems such as post event monitoring of account activity; and
- c. Reporting of Suspicious Transactions.

11. CONCLUSION

It is expected henceforth that NBFIs will follow, at a minimum, this guidance notes and will exercise extreme caution when dealing with countries on the UN or EU sanctions lists, or residents of those countries, or transactions associated with those countries (see EU Sanctions Risk List Countries). NBFIs are expected to enhance their risk management programs to ensure that they are not engaging people or entities that are appreciably exposed to proliferation risks, rather than attempting to manage those risks.

Any NBFIs operating internationally, or possessing international clients, who choose to do business with countries with a high risk profile, will need to know in real time which countries are on the EU or UN sanctions lists, as per the UK/EU Specially Targeted List or as per the OFAC listing, and carefully monitor any connections to those countries, including reporting suspicious transactions to the Financial Intelligence Agency in a timely manner.

NBFIs should be sensitive to the risks associated with financing the potential tools of proliferation, including nuclear and dual use material, and military items.

*** END ***

Graham —