COLLAS CRILL

Proliferation and proliferation financing in Guernsey

MARCH 2023

Proliferation and proliferation financing (collectively "**PPF**") are both significant threats to global peace and security. Given current instability arising from Russia's invasion of Ukraine and the knock-on political impact worldwide, it is now more important than ever for financial services businesses ("**FSBs**") to understand and recognise what is meant by PPF and have systems and controls in place to prevent and detect it.

In this guide we address three simple questions:

1. What does PPF mean?
2. What are countering PPF obligations for FSBs?; and
3. What should FSBs do to ensure they continue to meet their obligations?

1. What does PPF mean?

Proliferation:

Proliferation is the delivery system of weapons of mass destruction ("**WMD**") to states, non-state actors or individuals who are not authorised to possess them.

It includes the development, production, acquisition, transfer and use of WMD and any activity which supports these actions.

WMD includes explosive missiles or chemical, biological, radiological and nuclear weapons that cause significant harm and can kill innumerable individuals, catastrophically damage infrastructure and cause irreversible harm to the environment.

Proliferation Financing:

Proliferation Financing refers to the financial transactions that facilitate proliferation or the delivery systems of WMD.

The Financial Action Task Force ("**FATF**") have issued the following 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*

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materials (including both technologies and dual use goods used for non-legitimate purposes), in contravention of national laws or, where applicable, international obligations.

2. What are countering PPF obligations for FSBs?

The FATF is an inter-governmental body, which sets international standards and recommendations ("**Standards**") on anti-money laundering, countering the financing of terrorism and countering proliferation financing (collectively **AML/CFT/CPF**).

In 2020 the FATF revised its Standards to require countries, financial institutions, designated non-financial businesses and professions and virtual asset service providers to identify, assess, understand and mitigate their PPF risks.

Although the Bailiwick of Guernsey is not a FATF Member, it is a Crown Dependency of the United Kingdom (the UK being a FATF Member) and is evaluated against the FATF Standards by MONEYVAL, which is a FATF-style Regional Body.

Guernsey's next MONEYVAL visit is expected to be in 2024. While we understand the evaluation will be based on the FATF Fourth Round (2013) Methodology, it is becoming increasingly clear that PPF is high on the agenda and therefore as a jurisdiction, it makes sense for FSBs to be prepared for it to be a point of interest of the visiting MONEYVAL assessors.

Relevant FATF PPF Updates:

February 2018	October 2020

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February 2018

Guidance on Counter Proliferation Financing

- Specifically addresses Recommendation 7; the requirement to implement targeted financial sanctions in relation to proliferation financing.

October 2020

Amendments to Recommendation 1 (assessing risks and applying a risk-based approach) and the Interpretive Notes

- Requires identification and assessment of the risk of PPF by countries and the private sector to take action to mitigate these risks; and enhance domestic co-ordination.
- The FATF made the following statement: *"financial institutions [.....] should identify and assess the risks of potential breach, non-implementation or evasion of targeted financial sanctions when dealing with their customers, and take appropriate mitigating measures commensurate with the level of risks identified. This will ensure that these entities are aware of the risks involved in their businesses and professions, and do not unwittingly support or become part of the proliferation financing networks or schemes, in contravention of the relevant obligations."*

June 2021

April 2022

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June 2021	April 2022
Guidance on Proliferation Financing Risk Assessment and Mitigation • Complements the February 2018 Guidance, and offers specific guidance on assessing and mitigating PPF risks.	Report on the State of Effectiveness and Compliance with The FATF Standards • Summarises the results from the 4th Round of Mutual Evaluations as at April 2022, with a specific focus on effectiveness. • Report notes the updates to Recommendation 1 in October 2020 on PPF risk assessment and notes that "Countries should **provide additional guidance** to relevant financial institutions [...] **in order to improve overall risk-awareness and address vulnerabilities to PPF.**"

Guernsey's legal and regulatory framework

The Guernsey legal framework surrounding PPF is well-established and has serious criminal consequences for non-compliance.

Guernsey's 2019 National Risk Assessment ("**NRA**") published in January 2020, refers to the proliferation of WMD when referring to targeted financial sanctions measures.

The GFSC's Handbook on Countering Financial Crime and Terrorist Financing (the "**Handbook**") includes the financing of the proliferation of WMD in its introduction and encompasses it within the ML and TF definition.

3. What should FSBs do to ensure they continue to meet their obligations?

As preparations for the MONEYVAL inspection continue apace, the focus on PPF may well become more prominent, not least in light of the comments in FATF's April 2022 report, that encourages countries to provide additional guidance to improve overall risk-awareness and address vulnerabilities.

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FSBs would be well placed to prepare themselves for scrutiny of their PPF risk framework(s) and questions from the Regulator, and potentially MONEYVAL, on the state of their effectiveness and compliance with their PPF obligations.

Read, review and update

Given the heightened awareness and interest in PPF, MLCOs may wish to consider doing the following to ensure that PPF risks of the firm have been clearly identified, assessed, understood and mitigated.



Read:

- FATF's Guidance on PPF Risk Assessment and Mitigation
- Bailiwick of Guernsey NRA
- UK's NRA of Proliferation Financing
- JFSC's Guidance on countering the financing of proliferation of weapons of mass destruction



Review:

- Assess PPF risk, adopting the same risk assessment methodology used by the firm for all risks: identify, assess, manage, mitigate and monitor
- Consider the firm's vulnerability to PPF, in particular:
  - products or services provided;
  - clients;
  - third parties; and
  - jurisdictions.
- Dual use goods are a complex area and some client activities may be captured. Ensure that the firm can show an understanding of any vulnerabilities found and that they have implemented controls to mitigate those risks



Update:

- Address any deficiencies or weaknesses found as part of your review.
- If necessary, enhance:
  - the firm's own business risk assessment to include PPF risks;
  - reference to PPF risk in the firm's risk appetite statement;

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  - the firm's client risk assessment, and associated periodic review policies required by the Handbook to address PPF risk;
  - reference to PPF in all relevant AML/CFT/CPF policies, procedures and controls;
  - the compliance monitoring programme oversight, including any updates made as part of this review.

- Consider the adequacy of the firm's sanctions screening regarding PPF, particularly given the structures that may exist. Where a vulnerability has been identified, ensure that adequate measures to mitigate this vulnerability, such as enhanced due diligence procedures;
- Consider if the firm is exposed to third party vendor risk (both at a firm level and a client level). Ensure the firm understands who its clients are contracting with and if this increases the risk of involvement;
- Ensure the firm communicates any updates to the risk framework environment to relevant staff and that, where necessary, training is provided by the firm, particularly on identifying and reporting requirements.

Conclusion

In light of increasing international pressure, PPF is likely to be a focus of any potential GFSC onsite visit to MONEYVAL. Now may be a good time for MLCOs and Boards to review the existing framework to ensure that PPF risk is fully captured and make any necessary updates.

For those of us in governance, risk and compliance roles, now is the time to:

- Consider (and document) the appropriateness and effectiveness of the firm's risk framework around PPF/CPF;
- Where any deficiencies or new risks are identified, take appropriate action to remediate those deficiencies and enhance the risk framework.

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