Proliferation Financing

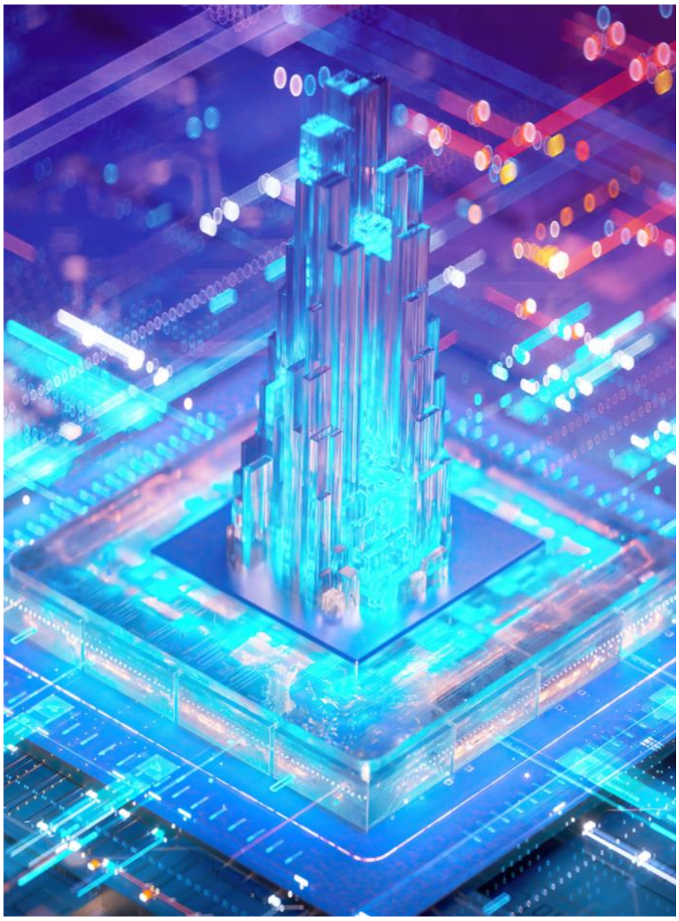
Getting up to speed with Bank Negara Malaysia's policy for enhanced risk mitigation

KPMG in Malaysia

Money laundering and terrorism financing (ML/TF) represent illicit financial activities that wield detrimental security and socio-economic repercussions. Perpetrated by criminal networks and terrorist financiers, these crimes thrive by exploiting vulnerabilities in an ever-interconnected world, evading detection of their illicit funds. The complexities of globalization and technological progress, coupled with the emergence of novel actors and innovative financial products, present formidable obstacles for regulators and law enforcement agencies in their efforts to thwart criminal enterprises.

In the dynamic realm of financial crime and regulatory risk management, one relatively new area that is less understood in comparison to ML/TF protrudes: proliferation financing. As global concerns mount over Weapons of Mass Destruction (WMD), financial institutions, along with Designated Non-Financial Businesses and Professions, and Non-Bank Financial Institutions (collectively known as Reporting Institutions or RIs) find themselves at the vanguard of fortifying global security.

The United Nations Security Council (UNSC) has long identified that the spread of WMDs represents one of the paramount threats to international peace and security in the 21st century.[1] **Proliferation financing (PF)** 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."[2]



1. United Nations Security Council Resolution (UNSCR) 1540 (2004), *United Nations Security Council (UNSC), 2004*
2. Combating proliferation financing: A status report on policy development and consultation, *Financial Action Task Force, (FATF) February 2010*

The consequences of PF extend beyond just geopolitical ramifications, permeating various aspects of society and global stability:

01

Deprives communities of resources vital for development and humanitarian assistance. The United Nations Office for the Coordination of Humanitarian Affairs (OCHA) reports that regions affected by proliferation financing often face heightened humanitarian needs.[3]

02

Regions plagued by proliferation financing experience reduced foreign direct investment (FDI) inflows and diminished economic growth prospects.

03

Pose significant environmental risks as the use of chemical, biological, or nuclear weapons can result in radiation contamination, ecosystem destruction, and long-term health hazards. The Nuclear Threat Initiative (NTI) warns that a nuclear exchange resulting from proliferation financing could trigger a nuclear winter, causing widespread agricultural failure and ecosystem collapse, with devastating consequences for global biodiversity.[4]

The Financial Action Task Force (FATF) – cognizant of the multifaceted grave implications of PF – has mandated countries and their RIs to identify, and assess the risks of potential breaches, non-implementation or evasion of the targeted financial sanctions related to PF, and to take actions to mitigate these risks as well as to enhance domestic co-ordination. These were solidified as amendments to FATF's Recommendation 1 and Recommendation 2 and its Interpretive Notes on 23 October 2020 and support the global response to PF of WMDs.[5]

Keeping pace with Bank Negara Malaysia's regulatory imperatives

In response to recent amendments to regulatory frameworks, it is essential for Malaysian RIs to reassess and fortify their policies on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT). The urgency of this matter is underscored by the issuance of revised policy documents by Bank Negara Malaysia (BNM) on Anti-Money Laundering/Counter Financing of Terrorism/Counter Proliferation Financing (AML/CFT/CPF) and Targeted Financial Sanctions (TFS) for both Financial Institutions (FIs)[6] and Designated Non-Financial Businesses and Professions (DNFBPs) and Non-Bank Financial Institutions (NBFIs)[7] on 5 February 2024, aligned with the international standards set forth by the FATF.

The central bank's proactive measures to adhere to FATF standards necessitate RIs to integrate PF risk assessment into their Institutional Risk Assessment (IRA) strategies. This entails identifying and assessing PF risks associated with customers, countries, products, services, transactions or delivery channels. By adopting this approach, RIs can effectively allocate resources and strengthen their overall PF combating framework. These tighten in regulatory expectations are reflected in the aforementioned policy documents.

The need to incorporate PF risk into IRA is underscored by the complexity and gravity of PF risks, which refers to breaches, non-implementation or evasion of targeted financial sanctions obligations. Incorporating PF risk into IRA is not just a regulatory checkbox, it's a strategic imperative. Failure to address PF risks not only undermines financial integrity but also jeopardizes global security.

3. Global Humanitarian Overview 2022 (Part One), *United Nations Office for the Coordination of Humanitarian Affairs (OCHA), 2022*
4. Implications for Nuclear Policymaking, Then and Now, Nuclear Threat Initiative (NTI), *19 October 2023*
5. Public Statement on Counter Proliferation Financing, *Financial Action Task Force (FATF), 2020*
6. Policy Document on Anti-Money Laundering, Countering Financing of Terrorism, Countering Proliferation Financing and Targeted Financial Sanctions for Financial Institutions (AML/CFT/CPF and TFS for FIs), Bank Negara Malaysia, *5 February 2024*
7. Policy Document on Anti-Money Laundering, Countering Financing of Terrorism, Countering Proliferation Financing and Targeted Financial Sanctions for Designated Non-Financial Businesses and Professions (DNFBPs) and Non-Bank Financial Institutions (NBFIs) (AML/CFT/CPF and TFS for DNFBPs and NBFIs), *Bank Negara Malaysia, 5 February 2024*

Maneuvering through the intricacies of PF risks

PF presents a myriad of complexities and challenges for RIs in their day-to-day operations and delivery of financial products and services. These challenges arise from the unique nature of PF risks and the interconnected nature of the global financial landscape.

01 Cross-border transactions:

PF often involves intricate networks spanning multiple jurisdictions. RIs engaged in cross-border transactions face the challenge of navigating diverse regulatory environments, varying levels of enforcement and potential jurisdictional conflicts. Identifying and mitigating PF risks across borders requires a high degree of coordination and cooperation with international counterparts, adding layers of complexity to compliance efforts.

02 Dual-use goods and technologies:

PF often involves the procurement of dual-use goods and technologies, which have legitimate civilian applications but can also be used in the development of WMDs. RIs involved in financing or facilitating transactions for such goods and technologies must exercise heightened due diligence to distinguish between legitimate and illicit activities. This requires specialized expertise and resources to assess the potential proliferation risk associated with specific transactions or counterparties.

03 Complex ownership structures:

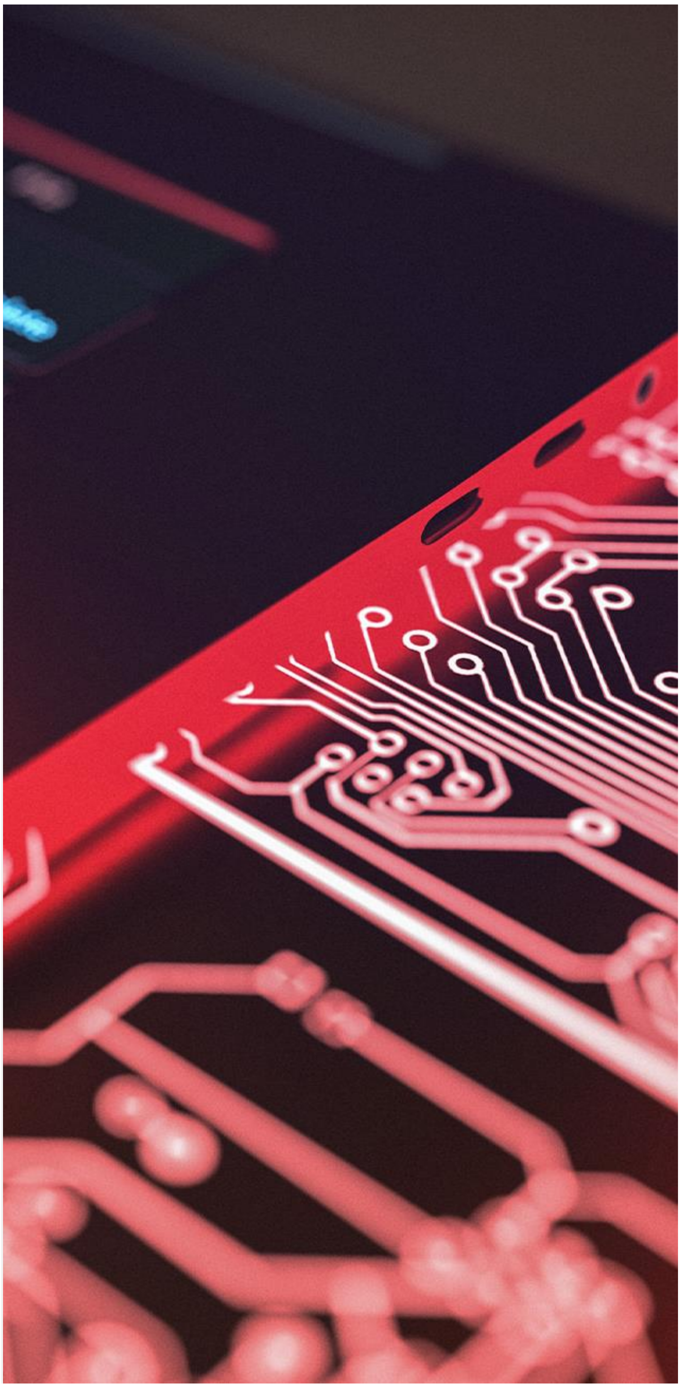
PF networks frequently employ complex ownership structures and shell companies to obfuscate the true beneficiaries of transactions. RIs encounter challenges in identifying beneficial owners and ultimate beneficiaries, particularly in cases involving opaque corporate structures or nominee arrangements. This opacity increases the risk of unwittingly facilitating PF activities and underscores the importance of robust customer due diligence measures.

04 Emerging threats:

PF risks continue to evolve, with proliferators adopting innovative tactics to evade detection and exploit vulnerabilities in the financial system. RIs must remain vigilant to emerging threat vectors, such as the use of emerging technologies (for example, cryptocurrencies) or non-traditional financial channels (for example, trade-based money laundering). Staying abreast of these evolving risks requires ongoing investment in technology, training, and intelligence capabilities.

05 Reputational risks:

In addition to regulatory and financial risks, RIs face significant reputational risks associated with PF. Being implicated in PF-related activities can tarnish an institution's reputation, erode customer trust, and result in severe reputational damage. This underscores the importance of robust risk management frameworks and proactive measures to mitigate PF risks, safeguarding both financial and reputational integrity.



As the regulatory landscape evolves and PF risks become more pronounced, RIs must proactively enhance their AML/CFT frameworks. Addressing these complexities requires a multi-faceted approach and a look into the implementation of a comprehensive IRA which for a strategic outlook, encompassing precise definition, on regulatory compliance, technological innovation, enhanced due diligence, robust transaction monitoring, employee training, collaboration, and continuous review.

While the task may seem daunting, specialist consultants offer invaluable expertise in crafting bespoke risk mitigation strategies tailored to the specific needs of FIs. By proactively addressing these challenges, RIs can not only enhance their own resilience to PF threats but also contribute to broader efforts to safeguard global security and stability.

KPMG’s methodology in proliferation financing risk mitigation

01

One size doesn't fit all. The key to mastering PF risk lies in a custom-made Institutional Risk Assessment (IRA) tailored to suitably accommodate a specific RI’s level of risk exposure. Our consultations specialize in decoding the intricacies, ensuring that RIs are fortified against the subtle nuances of PF threats. The custom-fitted IRA will pave the way to multiple efficiencies, be it time or cost.

02

It's time for RIs to rise to the occasion. Incorporating PF risk into your IRA is not just a regulatory requirement, it's also a commitment to global security. Our consultations can provide the compass to navigate these turbulent waters, empowering RIs to be formidable guardians against PF threats.

03

In the battle against PF threats, knowledge is power. Our consultants have the specialist expertise and cross-industry experience to empower RIs by providing actionable insights and strategies that go beyond mere compliance.

Connect with our professionals

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