

Proliferation Financing Risks Guidance

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Isle of Man
Government

Reilrys Ellan Vannin

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Introduction

This Notice has been published by the Customs and Immigration Division of the Treasury to highlight potential risks to businesses in the Island from —

- proliferation; and
- proliferation financing,

and how to mitigate those risks.

Who should read this Guidance?

This guidance is intended to help inform Isle of Man businesses who are —

- in the “regulated sector” (see Schedule 4 to the Proceeds of Crime Act 2008)
- trade in goods, especially those that are subject to export or trade controls
- involved in international trade.

Contact details for enquiries

Enquiries concerning this Notice may be made by —

- Email sanctions@gov.im
- Telephone 01624 648109

Privacy Notice

The Treasury collects information about you in order to administer taxation and carry out other functions for which it is responsible (e.g. National Insurance, customs and excise duties, property rates, social security benefits, state pensions and legal aid etc.), and for the detection and prevention of crime.

Whilst that information will primarily be provided by you, where the law allows we may also get information about you from other organisations, or give information about you to them. This may be to check the accuracy of the information provided, prevent or detect crime or protect public funds in other ways. These organisations may include other government departments, the police and other agencies.

To find out more about how we collect and use personal information, contact any of our offices or visit our website at:

<https://www.gov.im/about-the-government/departments/the-treasury/privacy-notice/>

The Isle of Man Government does not, and will not, tolerate the use of the Island, its company and business structures, or other facilities for the purposes of proliferation and proliferation financing.

Anyone with any evidence or suspicions about activity connected to proliferation or proliferation financing MUST report it as soon as is practicable.

Why can it be difficult to identify activity linked to proliferation, or proliferation financing?

You can be faced with a number of problems in attempting to identify proliferation financing ("PF"). Indicators of PF identified by the Financial Action Task Force ("FATF") are not unique to PF. They could also be indicative of trade-based money laundering, avoidance of tax or duties, or other issues. The following table compares indicators of money laundering with terrorist financing and PF¹.

	Money Laundering	Terrorist Financing	PF
Source of funds	Internally from within criminal organisations	Internally from self-funding cells (centred on criminal activity) Externally from benefactors and fund-raisers	State-sponsored programs
Conduits	Favours formal financial system	Favours cash couriers or informal financial systems such as hawala and currency exchange firms	Favours formal financial system
Detection Focus	Suspicious transactions such as deposits uncharacteristic of customer's wealth or the expected activity	Suspicious relationships, such as wire transfers between seemingly unrelated parties	Individuals, entities, states, goods and materials, activities
Transaction Amounts	Large amounts often structured to avoid reporting requirements	Small amounts usually below reporting thresholds	Moderate amounts
Financial Activity	Complex web of transactions often involving shell or front companies, bearer shares, high risk jurisdictions	Varied methods including formal banking system, informal value-transfer systems, smuggling of cash and valuables	Transactions look like normal commercial activity, structured to hide origin of funding
Money Trail	Circular – money eventually ends up with the person who generated it	Linear – money generated is used to propagate terrorist groups and activities	Linear – money is used to purchase goods and materials from brokers or manufacturers

¹ Source: [Study of Typologies of Financing of WMD Proliferation](#) published by Project Alpha at the Centre for Science and Security Studies at King's College London.

Risk assessment and mitigation

Businesses in the regulated sector are at the front line of combating PF. FATF have issued [guidance in relation to PF risk assessment and mitigation](#), which states that you will need to develop a clear understanding of the contextual information and the sources of PF risks that you are exposed to, and take appropriate measures to mitigate them.

The [FATF Standards](#) establish international rules for the implementation of targeted financial sanctions relating to the prevention, suppression and disruption of proliferation of WMD and PF (TFS-PF). These are prescribed in the FATF Recommendations, interpretative notes and methodology.

In the context of FATF Recommendation 1, PF risk refers strictly and only to the potential breach, non-implementation or evasion of the targeted financial sanctions relating to proliferation in Recommendation 7.

Recommendation 7 sets out the obligations to implement, without delay, targeted financial sanctions in relation to —

- the Democratic People’s Republic of Korea
- Iran (nuclear).

Businesses in the regulated sector are subject to the requirements contained in —

- the Anti-Money Laundering and Countering the Financing of Terrorism Code 2019 (the “AML/CFT Code”)
- the Gambling (Anti-Money Laundering and Countering the Financing of Terrorism) Code 2019 (the “Gambling Code”)
- the Anti-Money Laundering and Countering the Financing of Terrorism (Specified Non-Profit Organisations) Code 2019,

as appropriate to your business.

These Codes set out the preventative measures that you must have in place to prevent money laundering and the financing of terrorism or proliferation. Further information is available on the Isle of Man Financial Services Authority [website](#).

These Codes require you to take a risk based approach to identify and assess the risks you and your customers face, and to ensure you apply appropriate controls and procedures within your business and on your customers. The following information is designed to assist you with identifying and mitigating any PF risk.

PF Risk categories

FATF provides a list of PF risk indicators including those relating to —

- customer profile
- account and transaction activity
- maritime sector risk indicators
- trade finance.

Those PF risk indicators and how to mitigate those risks can be found in the FATF [Guidance on proliferation financing risk assessment and mitigation](#) (see page 17 onwards)

Country or geographical risk

Connections to certain countries may indicate a higher PF risk. For example —

- Commercial or business links, or financial relationships (such as correspondent banking relationships) with a country that is subject to UN sanctions imposing WMD-related restrictions (North Korea and Iran, or countries in their close proximity)
- Commercial or business links, or financial relationships (such as correspondent banking relationships) in countries with diplomatic, trade, or corporate links to States of Proliferation concern, or in their close proximity, for example, countries involved in networks identified in United Nations Security Council's Panel of Experts' [reports](#)
- Links with countries subject to other WMD Proliferation restrictions, for example, an "embargoed destination" or other Proliferation concern countries' lists identified in Schedules 1 to 4 of the [Export Control Order 2008](#)
- Links with countries presenting on-going and substantial financial crime risks, for example countries with strategic trade controls deficiencies identified by the [Peddling Peril Index](#)
- Other relevant factors could include countries with high levels of terrorist activities, corruption, civil unrest, organised crime related to arms dealing etc.

Customer risk

Specific categories of customer whose activities may indicate a higher PF risk are —

- those on national lists concerning WMD Proliferation
- a military or research body connected with a higher-risk jurisdiction of proliferation concern
- a customer involved in the manufacture, supply, purchase or sale of dual-use items, proliferation-sensitive or military goods
- a customer is a small trader/intermediary, who may be a dual-national of country of proliferation concern
- a customer located in a major financial or trade centre
- customers involved in the maritime industry, particularly those who own, operate, and/or provide services to ships operating in areas identified as posing a high risk for sanctions evasion.

Products and services risk

The following may suggest higher PF risks —

- the delivery of services subject to sanctions (e.g. provision of correspondent banking services affected by UN sanctions measures)
- project financing of sensitive industries in jurisdictions of proliferation concern
- trade finance services, transactions and insurance products involving jurisdictions of proliferation concern
- the transfer of dual-use, proliferation-sensitive or military goods, particularly if to a jurisdiction of proliferation concern or diversion concern. Diversion refers to transactions that diverge funds/resources away from their legitimately intended purpose to benefit proliferators, directly or indirectly
- maritime insurance and re-insurance services.

Mitigating the risks

As well as risk factors, mitigating factors should also be considered. For example, whether a customer or client is aware of proliferation risks and has systems and processes to ensure their compliance with export, trade control and sanctions obligations and can provide copies of export control or other licences required.

The level of mitigation will depend on the level of risk associated with your business.

The measures that could be taken to reduce the risk of PF include —

- improved on-boarding processes for customers (including beneficial owners)
- enhanced customer due diligence procedures
- effective maintenance of customer master data
- regular controls to ensure effectiveness of procedures for sanctions screening
- leveraging the existing compliance programmes (including internal controls) to identify potential sanctions evasion.

Risks identified	Possible mitigation measures
Potential breach or non-implementation of PF sanctions	<ul style="list-style-type: none"> • Adequate and effective on-boarding processes and procedures for customers (including beneficial owners, controllers and their associates) • Enhanced customer due diligence procedures • Effective maintenance of customer data • Maintaining and managing internal watch lists of customers, associated parties, ships, aircraft, entities or persons identified as potentially related to the PF sanctions designated persons • Adequate controls to ensure effective sanctions screening to identify and mitigate potential sanctions evasion • Maintaining sound processes and internal controls, ensuring these are followed • Providing staff training to include PF risks, typologies, required risk mitigation measures, policies and procedures • Timely monitoring and incorporation of amendments to UN designations • Demonstrating awareness of entities and persons who are not designated, but who are known to have connections to proliferation activities
Evasion of financial sanctions	<ul style="list-style-type: none"> • Incorporation of, and continued review and update of, relevant sanctions evasion information into internal risk • Tailored sanctions staff training • Supplementing reliance on list-based screening by enhanced customer due diligence measures to also capture indirect relationships and underlying assets which may be included on a sanctions list • Understanding the overall structuring of a corporate structure • Maintaining documentation which clearly sets out who is responsible for the screening systems within a Group and maintain access to that function

Enhanced due diligence checks

You should apply, on a risk-based approach, enhanced customer due diligence measures in any situation which by its nature can present a higher risk of money laundering, the financing of terrorism or PF.

It is a matter for you to determine the enhanced due diligence measures to be applied. However, such additional information may include –

- purpose of transaction or payment
- details about the nature, end use or end user of the item
- parties to the transaction
- sources of funds
- beneficial ownership of the counterparty
- export control information, such as copies of export control licences
- information in connection with wire transfers.

Checks on the goods involved

Where you, or your customer are involved with the trade in goods, you should take appropriate action to mitigate against PF. The measures that could be taken to reduce the risk of PF include —

- Checking if goods are subject to export controls, including dual-use goods. The UK's Department for International Trade has a [goods checker tool](#) to assist businesses
- Ask the customer for copies of valid export licences
- Checking controlled or sensitive goods against lists produced by international bodies, such as —
 - [Nuclear Suppliers Group](#)
 - [Missile Technology Control Regime](#)
 - [Wassenaar Arrangement](#)
 - [Australia Group](#)
 - [Zangger Committee](#)

If a customer is unable to provide the information about the goods, then an alternative is to ask that the customer provide evidence, by reference to export control and import control requirements in the relevant jurisdiction, that the goods do not require a licence in either the country of departure or arrival (or end-use).

“Red flags” - Indicators which may indicate proliferation or PF

Indicators of possible PF include²:

- ❗ 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 such 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 counter-party 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

² Source: FATF Proliferation Financing Report 2008 <https://www.fatf-gafi.org/media/fatf/documents/reports/Typologies%20Report%20on%20Proliferation%20Financing.pdf>

- ✘ 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 capitalisation 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

Trade finance and insurance products

A significant proportion of PF activities are said to utilise trade finance as a vehicle. Special attention should therefore be given to certain trade finance and insurance activities. These are —

- ✘ direct loans or general credit facility to facilitate export transactions
- ✘ the purchase of promissory notes or bills of exchange issued by foreign buyers to exporters for the purchase of goods and services, freeing up cash for the exporter
- ✘ factoring - the purchase or discounting of a foreign account receivable for cash at a discount from the face value
- ✘ the provision of guarantees to or by financial institutions on behalf of exporters such as pre-shipment guarantees and performance guarantees
- ✘ the provision of insurance against certain risks in the trading process.

PF typologies and case study references

- FATF [Proliferation Financing Report](#)
- [FATF Guidance on Counter Proliferation Financing](#)
 - sections 33 and 34 describe when you may be more vulnerable to PF and factors relevant to North Korea
 - sections 41 to 52 provide examples of risk which may help identify high-risk customers and transactions, enhanced scrutiny and follow-up actions to take
- Nuclear Suppliers Group - provides [good practice guides](#)
- Stockholm Institute for Peace Research Institute (SIPRI) [good practice guides](#) for the transport sector
- [Study of Typologies of Financing of WMD Proliferation](#) published by Project Alpha at the Centre for Science and Security Studies at King's College London. Includes 60 case studies based on analysis of a variety of official data.
- Countering Proliferation Finance: [An Introductory Guide For Financial Institutions](#) published by the Royal United Services Institute (RUSI) Provides indicators of PF and case studies
- How North Korea acquired [Chinese Transporter-Erector-Launchers \(TEL\) ballistic missile launchers](#)
- [Phosphate Fertilizers as a Proliferation-relevant Source of Uranium](#)
- [Countering the Challenges of Proliferation Financing](#) published by the University of Albany

Amendments to this Notice

This notice was first published on 3 September 2018.

March 2023	Rewritten to improve reader experience and update reference material
August 2023	New case study reference added on page 9
April 2024	Updated links