April 9, 2021

Mr. David Lewis
Executive Secretary
Financial Action Task Force (FATF)
2 Rue André Pascal 75116
Paris, France

RE: Public Consultation on FATF Guidance on Proliferation Financing Risk Assessment and Mitigation

Dear Mr. Lewis:

The Institute of International Finance (the "IIF") appreciates the work of the Financial Action Task Force (the "FATF") in its efforts to mitigate proliferation finance ("PF") and sanctions risk through amendments to FATF's Recommendation 1 ("R.1") and its Interpretive Note ("INR.1")[1] and through the Public Consultation on Guidance on Proliferation Financing Risk Assessment and Mitigation (the "Consultation" or the "draft guidance").[2]

We were very grateful for the opportunity to provide our initial comments on the guidance process in December 2020[3] and for the chance to have IIF members participate in the virtual hearing of the FATF Private Sector Consultative Forum ("PSCF") on the subject in January this year. The process of public consultation and dialogue on these important issues has been greatly valued by the financial services industry.

As noted in our December letter, we understand that the changes to INR.1 agreed in 2020 elucidate the revised concept that though financial institutions and Designated Non-Financial Businesses and Professions ("DNFBP") should have in place processes to identify, assess, monitor, manage and mitigate proliferation financing risk, this may be done *"within the framework of their existing targeted financial sanctions and/or compliance programs."*[4]

We appreciate that this change reflects upon the issues we expressed in our prior comments concerning potential negative effects from the amendments, such as the unnecessary duplication of risk management controls and the uncertainty in the regulatory interpretation of the new standards.[5] We believe, however, that the language could still be interpreted to require financial institutions to address PF risks separately,

[1] FATF, *Public Statement on Counter Proliferation Financing*, October 2020: http://www.fatf-gafi.org/publications/financingofproliferation/documents/statement-proliferation-financing-2020.html

[2] FATF, *Public Consultation on FATF Guidance on Proliferation Financing Risk Assessment and Mitigation*, March 2021

[3] IIF, *RE: FATF's Recommendation 1 and its Interpretive Note,* December 16, 2020

[4] FATF Recommendations, INR.1, Para 4, 17 and 18.

[5] IIF/Wolfsberg Group, *RE: Public Consultation on FATF's Recommendation 1 and its Interpretive Note*, September 3, 2020: https://www.iif.com/Portals/0/Files/content/Regulatory/09_04_2020_iif_wolfsberg_response_letter.pdf

rather than as one of the risks within their current AML/CFT and sanctions framework.[6] As such, there remains concern regarding the unnecessary duplication of risk mitigation efforts in relation to PF and sanctions risk and the layering of compliance requirements. Such concern will remain until there is a clear message that reliance on existing mitigation mechanisms is sufficient and that no additional risk assessment documentation would be expected.

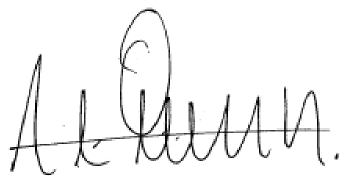
The finalization of guidance in this area is therefore extremely important to prevent misinterpretation which may arise through implementation of the changes to the FATF standards. Though guidance can only go so far in providing the regulatory certainty needed by both financial institutions and national authorities, it should critically ensure full use of the Risk Based Approach is permitted and encouraged and it should confirm that existing controls at financial institutions are not unnecessarily duplicated.

In this regard, however, we believe the Consultation reflects considerable ambiguity in terms of scope and utility. Even within the financial crime programs of financial institutions, there have been significantly different interpretations of how the FATF intends this guidance to be utilized. While the draft guidance states that if PF risks are already addressed within the existing risk assessment framework of financial institutions, a new or changed methodology is not necessary, the Consultation continuously indicates a *distinct* PF risk assessment process.

The document also intertwines the roles of the public and private sectors with regard to assessing PF risks, when in reality these two sectors are in very different positions to assess and address risks. The private sector can most effectively mitigate PF risks when governments take the lead in identifying the applicable risks in this area. Actionable information sharing from the public sector to the private sector is therefore critical to an effective PF framework and should be further emphasized within the final guidance. Lastly, where new national PF risk assessments are envisioned, financial institutions should be given sufficient time to implement measures based on those new assessments.

Thank you very much for considering our feedback and we look forward to discussing these issues in more detail as the final guidance is developed. If you have any questions, please do not hesitate to contact me or Matthew Ekberg at mekberg@iif.com .

Very truly yours,



Andrés Portilla
Managing Director, Regulatory Affairs
Institute of International Finance

[6] This is particularly relevant in terms of this consultation, as with exception to the beginning of the draft guidance, the document indicates a separate PF risk assessment process throughout.

Public Consultation on FATF Guidance on Proliferation Financing Risk Assessment and Mitigation

1. **Feedback on Consultation Questions**

Question 1: Does the Guidance provide sufficient clarity in distinguishing the mandatory requirements of the updated FATF Standards on proliferation financing risk assessment and mitigation, and additional measures that may support the implementation of these new requirements?

We believe the expectations of the private sector in the draft guidance are still generally unclear in distinguishing the mandatory requirements of the updated FATF standards. The requirements set out in the Consultation can only provide clarity in the presence of context provided by national/supra-national authorities. The level of clarity is heavily dependent on national risk assessments, inter-agency collaboration and information sharing. Currently, the difference between Money Laundering ("ML"), Terrorist Financing ("TF") and PF risks are notional and overlap with existing risk assessments which are performed (*e.g.,* customer profile risk indicators). There is still concern, therefore, that this will lead to real and unnecessary duplication at financial institutions.

For example, current sanctions programs already cover a "potential breach, non-implementation or evasion" of sanctions through screening and investigations – it is therefore unclear from the Consultation what exactly is required beyond this work already being done. The Consultation also does not fully clarify the roles of the public and private sectors, which is critical to the assessment of PF risks. The guidance discusses public and private sector responsibilities in the same context; however, this does not address the need for the public sector to have a guiding role.

As we have emphasized in the past, it is clear to us that without the sharing of PF relevant information across borders and with relevant stakeholders (including non-financial and impacted parties), the benefits of R.1 and INR.1 will be limited.[7] As such, the guidance should further address the effective use of public-private partnerships for managing PF risk.[8] Actionable information sharing from the public sector to the private sector (including the role governments/public authorities/multilateral regional bodies have in outlining threats and vulnerabilities via risk assessments) is the only truly effective way for financial institutions to manage PF risks. Up until now, the flow of relevant information to the private sector has been lacking and this should be addressed.

Question 2: Do you consider the four categories of risk indicators (including a sectoral focus on the maritime sector and trade finance) relevant, useful, and sufficient for your understanding of the risk of potential breach, non-implementation of evasion of proliferation financing targeted financial sanctions in the context of FATF Recommendation 7? What other indicators could be included in this section?

Overall, we believe the draft guidance does not clearly articulate how risk mitigation measures are to be applied for financial institutions that already have effective sanctions controls in place, which may lead to a level of ambiguity in implementation at national level when considering the four categories of risk indicators outlined. The level of interaction with the public sector on PF risk issues will also impact the

[7] We note that Page 13 of the draft guidance itself references that "For some of the risk indicators, the private sector will need additional contextual information from competent authorities, e.g., via engagement with law enforcement authorities or financial intelligence units."

[8] We note that Paragraph 45 and 46 of the draft guidance addresses public/private collaboration, however, this should be more clearly articulated throughout the final guidance as fundamental to managing risk.

relevance and usefulness of the risk indicators in the draft guidance and this should be addressed before finalization.

More specifically, the cases referenced in the draft guidance in relation to multiple United Nations Security Council Resolution ("UNSCR") Panel of Experts reports are useful insofar as those characteristics are acknowledged as part of the contextual analysis performed by national authorities. Financial institutions can only identify certain elements which out of context would not shed light on all the components described in the risk indicators.

For example, customer connection with a country of proliferation or diversion concern as an indicator is not useful on its own; however, when linked to sectoral vulnerabilities those indicators acquire more relevance. Indicators regarding other financial products could also be beneficial, particularly considering the vulnerabilities described therein on correspondent banking services and virtual asset service providers ("VASP").

Furthermore, the risk indicators themselves could benefit from greater clarity. For instance, maritime sector risk indicators could also include usage of free ports. This has been recognized by the European Commission Supranational Risk Assessment[9] as inherently exposed to ML and TF risk when used anonymously due to the high degree of security and discretion conducive to secrecy. Such characteristics seem to overlap with PF vulnerabilities. Risk-assessment procedures should also not be driven by indicators that are too generic and not specific to PF. The same applies to transaction monitoring requirements.

Overall, the more specific the risk indicator is, the more useful it will be in terms of aiding risk management without causing unintended consequences (*e.g.*, de-risking). It would be useful, for example, for the risk indicators to be reviewed in the context of a relevant geography – ideally this would be as specific as a particular region within a country. The private sector will be able to practically implement guidance more effectively when specific risk information is provided.

Question 3: Does the risk mitigation section of the Guidance provide sufficient clarity on how financial institutions and DNFBPs can address the risk of potential breach, non-implementation and evasion of targeted financial sanctions? What specific risk mitigation measures do you take to address such risks?

We reiterate in relation to question 3 that the draft guidance does not clearly articulate how risk mitigation measures are to be applied for financial institutions that already have effective sanctions controls in place. The risk mitigation section of the Consultation comprises mitigation activities already largely undertaken in the context of AML/CFT by financial institutions. For example, the usage of nexus to a country of proliferation as a specific risk indicator is already in use for both Customer Due Diligence ("CDD") and monitoring. The latter can be further refined with contextual information for the purpose of enhancing screening since, as explained throughout the draft guidance, using designated persons names alone is not effective due to the presence of third parties acting on their behalf.

Finalization of the guidance would benefit from greater recognition of these issues and a clearer focus on mitigating duplication of efforts and the negative consequences which could emanate from such replication.

---

[9] European Commission, *Supranational Risk Assessment*, July 2019

Question 4: Does the Guidance set clear expectations for financial institutions and DNFBPs in case of high-risk and low-risk customers and business relationships, including likely impact on de-risking and financial inclusion?

Although prescribed by the draft guidance, a proportionate implementation of the measures described therein would still remain a challenge, as most mitigation measures highlight elements which are already included in most risk assessment used for the purpose of ML and TF. This could lead to duplication of efforts impacting multiple customers who may have a legitimate nexus to a country of proliferation or diversion concern, ultimately potentially causing de-risking and creating difficulties for finding alternative means of financial intermediation.

Factoring in the usage of corporate service providers and front companies is already embedded within CDD assessments, however the burden of proof for legitimacy seems to be leaning increasingly towards financial institutions, although they can only rely on external sources and those provided by the customer itself. Consequently, a broad investigation to determine whether all contextual information is available for the materialization of specific typologies described in the UNSCR Panel of Experts reports entails multiple scenarios and may call into question business relationships.

The draft guidance also aims to create awareness on threats and vulnerabilities characteristic to PF and sanctions evasion, however, the determination of those which would lead to a customer risk classification of high/low risk are still largely matching those related to ML which already demand extensive research from financial institutions. The expectation would be that government and inter-governmental agencies embed all these characteristics for the timely detection of those facilitating PF and impose the corresponding penalties including designation where relevant. This should be also part of the assessment under Immediate Outcome 11 (core issues) among FATF members.

Again, as the draft guidance does not clearly articulate how risk mitigation measures are to be applied for financial institutions that already have effective controls in place, this may lead to a level of ambiguity in implementation at the national level creating unintended consequences including those concerning financial exclusion through the context of potential further de-risking. Making clear that if PF risks are already addressed within the existing risk assessment framework a new or changed methodology is not necessary would assist in this regard.

2. Specific Textual Comments

Though we emphasize throughout our response to the questions in the Consultation that clarification is needed overall in the draft guidance, we flag the following issues for completeness in the context of specific textual comments:

- Paragraph 70 states that *"mitigating sanctions evasion risks does not imply a "zero-failure" approach."* This is an extremely important point and should be reiterated in the supervisory section of the draft guidance.

- The following two key points are only referenced within the introduction of the draft guidance and are not reiterated throughout. Reference across the final guidance would be helpful to improve clarity and understanding of expectations:

- *The assessment of PF risks in this paper refers to a nexus with Iran or North Korea only*; and
- *A PF risk assessment does not have to be an individual exercise but can be covered by existing ML or Sanctions Risk Assessments.*

- The critical and clear point that financial institutions can use preexisting risk assessment programs to cover sanctions-related proliferation risk is not specifically made until paragraph 55. We suggest emphasizing this point in the first part of the final guidance.

- There is a strong connotation in paragraph 81, as there is throughout the document, that a proliferation finance risk assessment is a discrete exercise, separate and apart from preexisting sanctions and AML risk assessment efforts, that must be assessed independently by supervisors. This again reflects on the lack of clarity in overlapping requirements.

- The guidance references other sectors (such as the maritime sector, for instance) and their risk factors yet does not address these sectors specifically in terms of, *inter alia*, communication/outreach. Addressing the scope of the guidance and the responsibilities of sectors beyond financial firms and DNFBPs should be considered.

- We consider the suggestion in paragraph 30 (b) that financial institutions should review transaction records involving dual-use goods, when there are many thousands of such goods (many of which are common items) impractical and it should thus be reconsidered in the context of the final guidance.

- Paragraph 17 of the draft guidance states: "*The scope of this Guidance covers the risk assessment of the potential breach, non-implementation, or evasion of TFS referred to in Recommendation 7. These assessments may be conducted as part of broader National Risk Assessments (NRAs), or more specific stand-alone assessments. The FATF Standards do not require a risk assessment of broader PF risks."*

  In respect to this statement, we would welcome a more nuanced, risk-based, and proportionate approach for firms defined at the national level following the national PF risk assessment. Given the comments in paragraphs 24 and 25 (Preliminary Scoping) of the draft guidance, we would expect the FATF to direct that the PF risk assessment obligation on countries should be completed before every financial institution and DNFBP in that country commences their own exercise. Further guidance on national authorities to drive the right level of PF risk assessment according to their national risk assessment of PF risk would be welcome. Without clarification in this regard, there is concern that regulated entities will complete a full assessment of the risk following the FATF guidance, even though the national risk of PF may be very low.