September 3, 2020

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

RE: Public Consultation on FATF's Recommendation 1 and its Interpretive Note

Dear Mr. Lewis:

The Institute of International Finance (the "IIF") and the Wolfsberg Group appreciate the opportunity to provide input to the Financial Action Task Force (the "FATF") as it works to address many of the key issues facing the global financial community today. Our organizations have long supported the efforts of the FATF in establishing and promoting effective measures for combating money laundering ("ML"), terrorist financing ("TF") and other related threats to the integrity of the international financial system.

We are particularly grateful for the opportunity to comment on the public consultation on FATF's Recommendation 1 ("R.1") and its Interpretive Note ("INR.1" and collectively, the "Consultation")[1] and we support the intent of the proposed changes outlined by the FATF. Efforts to mitigate proliferation finance ("PF") risk and the consequences which flow from the potential breach, non-implementation or evasion of targeted financial sanctions obligations are laudable and strongly endorsed by the financial services industry. We particularly believe that the FATF should actively review the PF risk of its member jurisdictions, as the responsibility of countries to assess and understand their PF risk is a key component in addressing core systemic vulnerabilities.

We believe, however, that the proposals which are applicable to the private sector will not provide any tangible improvement to the overall effectiveness of efforts to reinforce the implementation of targeted financial sanctions related to PF. This is because without the underlying international cooperation on law enforcement mandates to tackle PF overall, and without the sharing of PF relevant information across borders and with relevant stakeholders (including non-financial and impacted parties) more specifically, the benefits will be limited.

Indeed, the amendments could result in significant negative unintended consequences depending on their country-by-country interpretation. They could ultimately detract from the core programmatic goal of a comprehensive financial crimes risk assessment that looks holistically at the full range of financial crime risk facing financial institutions, including but not limited to money laundering, terrorism finance, sanctions evasion, PF and a growing list of emerging threats. Major financial crimes risk assessment programs already can and do assess PF risk. Creating a requirement or perception of a requirement, to conduct an additional discrete, proliferation finance-specific risk assessment (and potentially other issue-specific risk assessments in the future) without greater public-private information sharing and/or a clear statement of national priorities would be unnecessary, potentially unsustainable and would result in little risk mitigation advantage.

[1] FATF, *Public Consultation on FATF's Recommendation 1 and its Interpretive Note*, June 2020

We suggest the FATF consider clarifying the amendments to address potential negative effects such as the unnecessary duplication of risk management controls and the uncertainty in regulatory interpretation of the new standards. It should also adopt specific and measurable guidance on R.1 and its interpretative note which will help establish, *inter alia*, a more reliable understanding of its intent and the consistent application of any new standards solely within the construct of potential breaches, non-implementation or evasion of the targeted financial sanctions related to PF, as contained in FATF Recommendation 7 ("R.7").

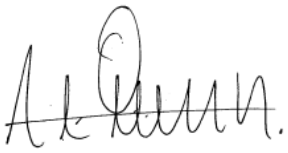
However, while additional drafting clarity and guidance pertaining to PF from the public sector may be helpful for financial institutions, we emphasize that it will still be difficult for the private sector to develop PF typologies and implement relevant controls based upon guidance alone. Actionable information sharing from the public sector to the private sector is the only truly effective way for financial institutions to address PF risks and we suggest that the work in this area be followed up with reforms to mitigate barriers to the exchange of financial crime data and enhancements to public/private cooperation through financial intelligence sharing public/private partnerships.

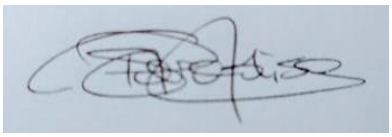
We note that a public consultation by the FATF on this issue is very much welcomed and we appreciate the additional time the FATF has granted to us for submission of our comments. As with other changes or updates to the standards or guidance documents issued by the FATF, we strongly believe the ultimate goals of the FATF and the wider financial, regulatory and law enforcement community will be better advanced through the institutionalized solicitation of stakeholder feedback in a clear and transparent fashion.

As such, we would appreciate the opportunity for a meeting between the IIF, the Wolfsberg Group, the FATF Secretariat and Policy Development Group ("PDG") and other relevant stakeholders to discuss our comments in more detail ahead of the October 2020 FATF Plenary. Such a meeting would allow for further in-depth discussion on the points raised by the industry which would hopefully help improve final outcomes and inform future work in this important area.

Thank you very much for considering our feedback and if you have any questions, please do not hesitate to contact us or Matthew Ekberg at mekberg@iif.com / the Wolfsberg Secretariat at info@wolfsberg-principles.com .

Very truly yours,





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Public Consultation on FATF's Recommendation 1 and its Interpretive Note

Key Issues:

Preventing the financing of the proliferation of weapons of mass destruction ("WMD") including chemical, biological and nuclear weapons is well recognized as a global priority and the efforts aimed at the mitigation of such financing are strongly endorsed by the financial services industry. The G20 has indicated their support for the work of the FATF in strengthening the global response to PF and concerted, coordinated efforts by both the public and private sectors will aid in accomplishing the vital goal of reducing the threats posed by WMDs.

Overall, the intent of the proposed changes outlined in the Consultation is in line with these wider objectives, along with the aim of tackling the consequences which flow from the potential breach, non-implementation or evasion of the targeted financial sanctions obligations in this area. However, we believe the changes would have limited benefit without discussions first on how the prevention of PF (which in itself is a complicated issue for authorities to tackle) can be better achieved overall and how any negative unintended consequences which may emanate from the proposed changes in the Consultation – particularly for regulated entities and the clients they serve – can be prevented.

As such we offer the following observations and suggestions to the FATF as it continues its important work, both on this consultation and the wider reform efforts to make the global framework for addressing financial crime risk more effective.

1. ***Scope and Interpretation of the Changes to R.1 and INR.1***

First, the Consultation states that financial institutions:

> *"…should be required to take appropriate steps to identify and assess their proliferation financing risks"* and that they *"should have policies, controls and procedures to manage and mitigate effectively the risks that have been identified."*

These recommended requirements could result in countries placing unreasonable expectations on financial institutions, which do not always have the complete context to differentiate PF from other types of financial crime. Though we believe that the current Anti-Money Laundering and Countering the Financing of Terrorism ("AML/CFT") framework is sufficient to address PF in terms of a risk-based approach – and this is taken into account in current policies and procedures applied across the financial services industry – it is difficult for financial institutions to distinguish proliferation financing from money laundering activity without the broader perspective that comes from increased public/private cooperation and information sharing.[2] The lack of clarity in the proposals overall also risks the real possibility of unnecessarily duplicating risk mitigation efforts in relation to PF and sanctions risk and layering compliance requirements – creating separate processes that do not rely on existing risk mitigation mechanisms and creating an expectation of additional risk assessment documentation by financial institutions.

[2] According to the US National Risk Assessment on Proliferation Financing (2018), a "challenge for FIs in detecting and mitigating PF activity is understanding how PF differs from other illicit financial activity such as money laundering or terrorist financing. For some, the segmenting of PF from other types of illicit financial activity may seem like a difference without distinction."

Second, we recognize that the proposed amendments outlined in the Consultation seek to reinforce the implementation of targeted financial sanctions by obliging financial institutions and Designated Non-Financial Businesses and Professions ("DNFBP") to assess the risks of breach, non-implementation and evasion of targeted financial sanctions related to PF, and to take appropriate mitigating measures commensurate with the level of risk identified. We also recognize that the changes are not intended to cover broader issues of counterproliferation and relevant activity-based prohibitions, which are out of scope of Recommendation 7.

However, given the nature of these changes there is concern that their implementation at national and regional level may be far less narrow than the one envisioned by the Consultation. Supervisory interpretation could be wider than R.7 and touch across other FATF Recommendations, substantially changing supervisory expectations which could impose unnecessary changes to other controls in the risk management framework. Supervisory misinterpretation of the changes can create real regulatory risk for the financial institutions expected to implement risk management modifications in line with the updated R.1 and INR.1 (particularly in relation to any additions to documented risk assessment processes). That risk is amplified by the fact that financial institutions may be expected to identify, assess, and mitigate PF risks, but they do not always have the complete context to differentiate PF from other financial crime, as noted above.

Third, the Consultation may also have the effect of shifting the FATF's Non-Proliferation Financing Guidance[3] from recommended sound practice to a regulatory expectation. Future Mutual Evaluations may now reflect how effectively R.7 on targeted financial sanctions is implemented, not just whether there is statutory underpinning, leading to potential misunderstandings in implementation depending on the jurisdictional approach.

Fourth, there is concern as to who would oversee risk assessment in this area jurisdiction by jurisdiction. The need under a revised R.1 to appoint an authority to oversee sanctions risk assessment could cause uncertainty in supervisory oversight for countries which do not have a methodology to address sanctions risk and money laundering/terrorist financing risk in a coordinated fashion. Two competing regulatory frameworks could cause confusion and be unnecessarily burdensome for regulated entities. It could also diminish the effectiveness of outcomes and impede regulatory objectives in the prevention of PF.

These issues can, collectively and individually, lead to unintended consequences if the proposed consultative changes are adopted as envisioned. Reevaluation of business lines and relationships leading to de-risking may ensue. In addition, even if there is true clarity that the new obligations relate only to the FATF recommendations highlighted in the Consultation, it is unclear how financial institutions can demonstrate the ability to apply commensurate measures in lower and higher risk scenarios. Traditionally, these measures are incorporated into a broader financial crime policy which would, for example, include CDD measures. Absent this, it is unclear how financial institutions can demonstrate that these measures are commensurate with the risk identified, which is likely to be a supervisory expectation. Similarly, risk assessments include controls that exist across the financial crime risk management program. As a result, incorporating a stand-alone PF assessment into the existing framework would have much wider implications to institutional programs, would likely become a supervisory expectation based on existing

[3] FATF, *Guidance on Counter Proliferation Financing - The Implementation of Financial Provisions of United Nations Security Council Resolutions to Counter the Proliferation of Weapons of Mass Destruction,* February 2018

risk assessments, be of questionable value absent increased information sharing by the public sector and would impose a burden whose benefit would not be commensurate with the required effort.

If the FATF proceeds with the amendments in the Consultation, it should ensure the issues outlined herein are addressed – preferably through R.1/INR.1 directly but also through actionable and enforceable guidance as discussed in Section 3 of this letter and – importantly – through broader reform efforts outlined in Section 2 of our submission. As such, the FATF should consider the following:

i. The FATF should ensure clarity in its intent and the consistent application of the new standards solely within the construct of potential breaches, non-implementation or evasion of the targeted financial sanctions related to PF, as contained in FATF R.7 and work to ensure any regulatory misinterpretation in implementation across the proposals is obviated.

ii. The FATF should reflect on applying the new standards to countries *ahead* of any requirements on financial institutions and DNFBPs (and other regulated entities as noted below). Placing updated requirements in the context of R.1 and R.7 on the private sector without first having countries take appropriate steps to identify and assess PF risks for their jurisdiction and inform potential changes to their countering proliferation finance ("CPF") regime – while at the same time making information available for PF risk assessments conducted by financial institutions and DNFBPs – would be a reversal of the natural order of proper risk management in this area.

iii. If the new requirements do continue to place obligations on the private sector, then the FATF should make clear that existing risk assessments and Customer Due Diligence ("CDD") and Customer Risk Rating ("CRR") processes can be leveraged to assess customers for proliferation/sanctions risk. It should not lead regulators to expect that financial institutions have a distinct and separate sanctions CRR or PF risk assessment and it should not cause the overall duplication of risk management mechanisms.[4] It should also not lead to unreasonable expectations on the differentiation of PF risk from other types of financial crime risk without the related context gleaned from effective public/private sector cooperation.

iv. The application of any final agreed amendments that apply to the private sector should not be limited to just financial institutions and DNFBPs. If the changes are adopted, the approach should be required across the whole of the regulated sector where possible. Unlike some other offenses, sanctions violations are not solely linked to financial institutions and DNFBPs. National Risk Assessments and mitigating actions need to consider other stakeholders, such as actors involved in export controls, in order to ascertain a full picture of the threat landscape.

2. Effectiveness of the Proposed Changes to R.1 and INR.1

In addition to the lack of clarity and the possible negative effects relating to the proposed changes, there appear to be few tangible benefits arising from the consultative proposals which apply to the private

[4] We note that additional, prescriptive risk assessment requirements also stand in tension with certain country specific approaches, such as recent Federal Financial Institutions Examination Council ("FFIEC") guidance in the United States which clarifies that there is no legal requirement to conduct a risk assessment and grants financial institutions broader discretion in the design and execution of risk assessment programs in apparent recognition of the growing opportunity costs associated with the exponential increase in bank risk assessment program investments.

sector. As discussed in Section 1 of this letter, the potential duplication of work or uncertainty in the regulatory interpretation of the envisioned amendments will do little to effectively combat PF or enhance sanctions risk controls without concomitant work in other areas which require reform.

The effectiveness of FATF standards is a key component of the FATF mandate. As such, in addition to assessment and mitigation efforts, the FATF and FATF jurisdictions should also reflect on the underlying systemic issues which would enable a more successful CPF regime. For example, this should include the review of law enforcement mandates in relation to the criminalization of PF, as a Suspicious Activity Report ("SAR") filing regime cannot be activated unless the underlying activity is criminalized. An effective risk assessment is part of a broader AML/CFT and CPF framework as it helps identify, assess, and mitigate risk to a jurisdiction as a whole. Absent a consideration of the inclusion of broader obligations for governments and the private sector to holistically identify, assess, share and mitigate PF risk, the impact seems very limited compared to the investments financial institutions will make to comply with a new obligation. If the expectation is not for financial institutions to file SARs to competent authorities, governments will not be notified of potential PF risk identified by the private sector and it will not inform government mitigation efforts.

In the same vein, the FATF should also examine where there is scope for increased information sharing on PF risk between relevant stakeholders (both public and private), including those in the non-financial sector and to impacted parties for a more comprehensive approach to the problem. The consultative amendments would have inadequate effects if the information garnered from risk assessments continues to be limited to within the financial institution itself. As we and the FATF have both emphasized, the management of financial crime risk can be improved by facilitating the increased sharing of information on financial activity linked to crime and terrorism, both domestically and internationally.[5] Further work to overcome issues such as inconsistent legal frameworks for data protection, privacy, and bank secrecy which present barriers that inhibit information sharing should be undertaken as a means of furthering the prevention of PF as well as other types of illicit financial flows.

Lastly, the FATF should acknowledge that financial crime risk management programs can effectively address PF through intelligence that is shared through public private partnerships ("PPP"). At the center of an intelligence-led financial crime mitigation model is the PPP – a collaboration between financial institutions, law enforcement and the regulatory community. Not only are PPPs an important first step in the ability to deliver operational benefits and efficiency gains, but they can also provide a framework to build the relationships and dialogue between stakeholders to help coordinate and catalyze coherent reform of the wider financial crime risk management framework. The same challenges on information sharing can exist for PPPs, however they can be an effective tool for addressing PF and should be considered as essential in the wider context of fulfilling the objectives of the Consultation.

3. Guidance on R.1 and INR.1

As noted, if the FATF proceeds with adoption of the amendments in the Consultation, the issues which could give rise to unintended consequences outlined in Section 1 of this letter should be addressed where possible in the drafting of R.1/INR.1 directly to avoid ambiguity in intent. This should also be followed up with clear guidance to prevent misinterpretation and reduce unnecessary burdens.

[5] For further information on these issues, please also see: IIF/Deloitte, *The Global Framework for Fighting Financial Crime: Enhancing Effectiveness and Improving Outcomes,* October 2019 and FATF, *Private Sector Information Sharing*, November 2017.

Though as stated, guidance can only go so far in providing the regulatory certainty needed by both financial institutions and national authorities without associated reforms delineated in Section 2 of this letter, it should ideally outline where perceived gaps exist and take into account all relevant stakeholders in this regard. It could give more detail regarding expectations on what the PF risk assessment would include, discuss the preventive measures expected by countries, financial institutions and DNFBs and should address the effective use of PPPs for managing PF risk.

The guidance 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. For example, paragraph 17 of the changes to INR.1 states that:

> "*Financial institutions and DNFBPs should always understand their proliferation financing risks, but competent authorities or SRBs may determine that individual documented risk assessments are not required, if the specific risks inherent to the sector are clearly identified and understood."*

It should be made clear that where financial institutions are already conducting PF and sanctions risk assessment as part of the broader enterprise risk assessment in line with the letter and spirit of paragraph 17, then this is sufficient to satisfy the requirements in the updated R.1 and INR.1.

We believe FATF should also further articulate its expectations on measures appropriate in relation to effectively managing and mitigating PF risks that are identified. Further clarity is needed, for example, on expected mitigation measures on dual use goods; while a critical component of PF, understanding and managing the risks of these goods and services is a complex area requiring specific expertise.

Further, proposed revisions to R1 state:

> "*Countries should take commensurate action aimed at ensuring that these risks are mitigated effectively, including designating an authority or mechanism to coordinate actions to assess PF risks, and allocate resources efficiently for this purpose*".

In this context, we believe the guidance would also need to address the complexities arising from managing varying regulatory expectations for international financial institutions arising from the appointment of such authorities at the country level.

Lastly, guidance must be applied in good faith across member state jurisdictions in order for it to be fully useful. A means of ensuring FATF guidance is adopted in a fulsome and transparent fashion across jurisdictions is ultimately needed. We note that in the past the FATF had undertaken a survey of its member states and the private sector on the adoption of the FATF Guidance on Correspondent Banking.[6] This exercise can be extremely helpful in understanding how guidance is applied, how it has helped achieve risk management objectives and what strategies are employed in implementing guidance across jurisdictions.[7] However, it must be followed up as part of ongoing review and dialogue with member states that may be lagging behind in adoption.

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[6] FATF, *Guidance Correspondent Banking Services*, October 2016. We note that in relation to the importance of transparency by the FATF, it would helpful for the results of these surveys to published and shared widely with the private sector and relevant stakeholders.

[7] A country to country comparison can also be carried out, comparing countries with high adoption rates compared with countries having difficulty in implementing the Guidance. The strategies adopted by these countries can be shared with other countries.