

## **Prevention of proliferation financing**

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Risks related to proliferation and terrorist financing, technological developments and the globalisation process are relevant not only for Latvia's national security, but also for the stability and reputation of the financial sector. Compliance with national and international sanctions is an investment in the fight against money laundering and terrorism and proliferation financing.

### **What is proliferation?**

According to the definition by FATF, proliferation is the transfer and export of nuclear, chemical, bacteriological, biological, toxic, or other weapons of mass destruction (hereinafter – WMD), means of their delivery and related materials (for example, technologies, goods, software, services, or expertise).

Means of delivery: ballistic missiles and other unmanned systems able to deliver WMD and especially designed for this purpose.

Related materials: materials, units, and technology, which are subjects of multilateral agreements and included in the national control lists due to their possible use for the development, manufacture, and application of WMD.

The definitions of proliferation have been transposed into national law. Section 5, Paragraph five of the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing provides that proliferation is the manufacture, storage, movement, use or distribution of weapons of mass destruction.

Also, Section 73 of the Criminal Law criminalizes the manufacture, storage, movement, use and distribution of weapons of mass destruction with life imprisonment or deprivation of liberty for a period of three up to twenty years.

### **What is proliferation financing?**

Proliferation financing (hereinafter – PF) is the collection or transfer of financial funds or other property with a view to use them for the manufacture, acquisition, storage, development, export, transshipment, mediation, transport, transfer, accumulation, or use of WMD and means of their delivery, as well as related materials. Proliferation financing differs from terrorism financing mainly in that mostly formal sources of financing system (banks and payment institutions, instead of cash, cryptocurrencies, *hawala*, etc.) are used. Thus, detection is made significantly more difficult since majority of transactions is structured similarly to other legal transactions to avoid standing out. Practically all performers of proliferation use complicated financial schemes and many screen companies, thus attempting to operate in the jurisdictions, where financial institutions have poor understanding of customer due diligence and risks.

Section 5, Paragraph five of the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing provides for the definition of proliferation financing – financing of

manufacture, storage, movement, use, or proliferation of weapons of mass destruction (hereinafter – proliferation) is the direct or indirect collection or transfer of financial resources or other property acquired by any form with a view to use them or by knowing that they will be fully or partly used to finance proliferation (hereinafter – proliferation financing).

Criminal liability for the financing of proliferation is provided for in Section 73.1 of the Criminal Law, for the financing of the manufacture, storage, movement, use or distribution of weapons of mass destruction, that is, direct or indirect collection of financial means or other property acquired in any way, or transferring thereof for the purpose of using them, or knowing that they will fully or partially be used for financing of manufacture, storage, movement, use and distribution of weapons of mass destruction — the applicable punishment is life imprisonment or deprivation of liberty for a period of eight up to twenty years, with or without confiscation of property.

### **Characteristics and risks of proliferation financing**

Signs that may indicate on proliferation or financing thereof (none of the signs can serve as the sole indication on a person's possible relation to proliferation):

- Financial institutions known for their deficiencies in the field of MLTPF are involved in the transaction or registered in the sanctioned or at-risk countries.
- Use of shell companies (in accordance with the Law on PMLTPF) or front companies.
- Use of forged documents (contracts, export permits).
- Paying inadequately high prices for goods, buying goods just below the quantity control limit.
- Use of payment agents, cash payments for goods or transportation services, cash payment for the first instalment.
- Use of personal account or credit cards for business payments.
- Payment instructions from persons excluded from the contracts.
- Withholding information on the end-user or end-use, providing it only on request, information on the end-use is unclear or inaccurate.
- Details of the contracts (names, addresses) do not match the purpose of payments.
- The final recipient has no connection with the buyer, no knowledge of the product.
- The order is not business related, lack of transaction history, the customer or end-user activity does not fit the business profile.
- The order has been placed from a country other than that of the final recipient.
- Route of the consignment is irrational (e. g., “circular”), use of multiple types of transportation/stops for one shipment.
- The freight carrier is indicated as the consignee.
- Transport identification data (vessel name) is concealed or hidden; container numbers are distorted.

- Inconsistency of ship routes with the plan, disconnection of the global positioning system (hereinafter – GPS) signalling device in the vicinity of at-risk countries (according to the FATF list).
- Contract excludes service, training, or installation.
- The trade financing transaction involves a shipping route that passes through a country with weak export control regulations and their application (at-risk countries such as Syria, Libya, Yemen, etc.).
- The transaction involves persons or companies located in at-risk countries.
- The transaction involves universities or military institutions located in at-risk countries.
- The transaction involves companies whose products are exempted from sanctions against countries (humanitarian aid – food, medicine).
- The transaction involves a shipment of goods that does not follow usual trade patterns (does the country involved normally import/export the goods?).
- Customer due diligence reveals evidence of long-term cooperation with a sanctioned person or region.
- The customer or its true beneficiary is from a sanctioned country (North Korea, Iran).
- The addresses of the companies coincide with the addresses of the embassies or other public institutions of certain countries.
- A small company transfers large amounts of money inconsistent with the size of the business.
- Transfers are always in US dollars only.
- The companies are inactive for long periods and are used to make several transfers within a short period of time.
- Within a short period of time since the opening of account, the officials and owners of the company change.
- Purchase of equipment by components without justification.

### **Risk assessment and preventive measures**

To successfully mitigate and prevent potential proliferation cases, the subjects of the law are required to ensure that the customers are verified against the United Nations (UN), European Union (EU), US Office of Foreign Assets Control (OFAC) and Latvian national sanctions lists, thereby safeguarding against serving sanctioned persons.

The risk-based approach may vary among the subjects, depending on the specifics of the subject's activities and risk appetite. To implement effective risk controls, subjects need to understand the potential risks of their activities, considering their business processes, customer base, and locations of service provision or location. Identified risks should be assessed (in terms of impact and likelihood) and constantly monitored, as well as subjected due diligence where indications are found. Publicly available information on countries, companies, vehicles, and persons involved in evasion of sanctions plays an important role in the implementation of a risk-based approach.

It should be noted that the main proliferation risk is posed by countries that have developed or are developing illegal systems of biological, chemical, or nuclear weapons. North Korea, India and Pakistan are countries that plan to maintain or improve their current WMD arsenals through proliferation, while Iran is a nuclear power that, due to extensive sanctions, is entirely dependent on proliferation to maintain its nuclear capabilities. Consequently, all bordering countries can also be considered high-risk, as the alleged transport of goods most often passes through neighbouring countries to hide the actual destination. High risk countries are also those where hostilities are ongoing, parts of the country are uncontrolled or terrorist groups are active (Afghanistan, Syria, Libya, Sudan, Somalia, Yemen, etc.). Awareness of the risks posed by certain regions and their financial institutions (e. g., relation of China and East Asian region with North Korea) is a mandatory first step in the fight against proliferation, so that appropriate risk control measures can then be put in place. Particular attention should be paid to underdeveloped regions, as insufficient border controls and developed smuggling networks create favourable conditions for proliferation, especially in countries bordering the at-risk countries. Trade relations between high-risk countries and other countries should be considered, as they can be used for conducting proliferation transactions.

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