

PROLIFERATION
FINANCING
RISK
ASSESSMENT



CONTENTS

BACKGROUND | PAGE 2

SCOPE & METHODOLOGY | PAGE 5

**EXAMPLE OF MODUS OPERANDI OF PROLIFERATION OF WMD
AND PF ACTIVITIES | PAGE 6**

FINDINGS | PAGE 3, 4, 7 & 8

RECOMMENDATIONS | PAGE 4 & 9

Background

- 1) The objectives of PFRA are to:
 - a) provide base line assessment to enhance understanding of Malaysia's risk exposure to proliferation financing (PF¹);
 - b) identify and address key vulnerabilities in the financial and designated non-financial businesses and professions (DNFBPs) sectors that may be exploited by proliferators to finance activities relating to proliferation of weapons of mass destruction (WMD) or to evade United Nations Security Council sanctions; and
 - c) support development of appropriate strategies and recommend measures in mitigating the risks and vulnerabilities identified to strengthen country's overall countering PF (CPF) framework.
- 2) The assessment is timely given the latest update from the Financial Action Task Force (FATF) in October 2020, which introduces a new obligation for country to identify and assess the risk of potential breaches, non-implementation or evasion of the targeted financial sanctions related to PF².
 - The PFRA will serve as a key step to ensure effective implementation of the remaining recommendation on private sector and enable country's full compliance to the amended Recommendations.
 - These ongoing developments will be assessed (changes to the international standards and anticipated FATF guidance on CPF) for possible recommendations or amendments to existing policy documents or issuance of guidance, if necessary.
- 3) Please turn to **page 5** for summary of the scope and methodology used for the risk assessment. Consistent with the revised FATF Recommendation 1, which requires countries to identify, assess and understand the PF risks for the country, the PFRA focuses on the exposure of the key sectors to PF risks from dealings with persons from countries of proliferation concern based on 3 years datasets between 2016 and 2018. The assessment methodology is founded on 2 main pillars as follow,
 - threats, vulnerabilities and likelihood; and
 - control measures.
- 4) The PFRA demonstrates the interconnectedness between the sources, movement of assembled parts, intermediaries and the proliferators, with linkages to the financing aspect. Please turn to **page 6** for the illustration of a common modus operandi of proliferation of WMD and PF.

¹ Proliferation financing 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. [FATF Report, *Combating Proliferation Financing: A Status Report on Policy Development and Consultation, February 2010*]

² FATF has adopted amendments to Recommendation 1 and 2 and their Interpretative Notes that require countries and the private sector to identify and assess PF risks, and to take action to mitigate these risks.

Findings

Malaysia's net risk for PF is determined to be at **medium low**³ level taking into account medium low level of overall inherent risks (threats, vulnerabilities and likelihood of occurrences) and acceptable level of control measures.

Overall Inherent Risks [Medium Low]

1) Malaysia has several structural/ enabling factors that contributed to the high level of WMD threats, which include:

- high level of accessibility by person from countries of proliferation concern;
- high integration level into global shipping network and potential access to world markets, high global trade connectivity and manufacturing sector competitiveness;
- relative speed and ease for formation of legal persons and businesses; and
- residual risks and threats from potential support network.

It is observed that despite the positive role some of the indicators mean for the country, the same advantages could be exploited by proliferators in pursuing their WMD proliferation activity.

2) Vulnerabilities in the financial and DNFBPs sectors are assessed to be low risk due to the following:

- general exposure to customers from countries of proliferation concern in terms of number and value; higher risk financial products and services, i.e. trade finance, cross-border remittance and marine insurance; and customer from higher risk sectors i.e. trading, manufacturing, transport or shipping sectors, are relatively low;
- there is some form (minimal) exposure to PF risk from indirect correspondent relationship with a country of proliferation concern; and
- none of the sectors have on-boarded nor provided financial services to PF-designated persons⁴.

From a sectoral risk exposure perspective, banks, including Labuan offshore banks and money services businesses are the most vulnerable sectors to proliferation financing risk. The risk is largely contributed by the size of customer base, transactions value and type of product or services offered, i.e. deposit, remittance and money changing.

3) Likelihood of occurrences of PF is assessed to be at medium low level in comparison to crimes from the National Risk Assessment on ML/TF conducted in 2016 (slightly below terrorism and terrorism financing) based on observation of cases reported in suspicious transaction reports, financial intelligence disclosed and cases investigated by the Royal Malaysia Police.

³ The risk ranking used in the assessment ranged from Low, Medium Low, Medium High and High.

⁴ PF-designated persons refer to individuals and entities designated by the United Nations Security Council. The list is accessible at <https://scsanctions.un.org/>.

Overall Control Measures [Acceptable]

- 4) The country's overall control measures against threats, vulnerabilities and likelihood of proliferation of WMD or PF is assessed to be acceptable mainly due to comprehensive legal framework to combat P and PF supported by acceptable level of domestic and international cooperation as well as adequate financial and DNFBPs sector oversight.

Please turn to **page 7 and 8** for the summary of findings.

Recommendations

- 1) The recommendations cover four broad areas i.e. legislative, policy and coordination framework; implementation and compliance by the financial, DNFBPs and export sector; heightened regulatory and supervisory initiatives; and intensified monitoring efforts and enforcement actions. Please turn to **page 9** for the detailed recommendations.
- 2) Future works on the recommendations will be driven and carried out by existing domestic coordination platforms such as the National Coordination Committee to Counter Money Laundering (NCC) (led by Bank Negara Malaysia) and Strategic Trade Action Committee (STAC) (led by Ministry of International Trade and Industry).

SCOPE AND METHODOLOGY

Scope



Scope of Assessment

The assessment will cover Malaysia’s exposure to proliferation of WMD activities with specific focus on the exposure to proliferation financing risks



Sanctioned Regimes

The assessment will focus on Malaysia’s exposure to proliferation financing risks arising from dealings with or exposure to persons from selected countries of proliferation concern only and will not include other UN-Sanctioned countries that are listed in the STA Order



Applicable Sectors

The assessment will include key reporting institutions licensed by BNM, SC and LFSA - onshore and Labuan banks and ITOs, MSB - and selected capital market service providers & DNFBNPs



Period of Review

The assessment will be based on 3 - year datasets from 2016 to 2018, to ensure comparability with NRA 2017 which was based on datasets from 2014 to 2016. If necessary, to use datasets from other period as part of qualitative assessment

Methodology

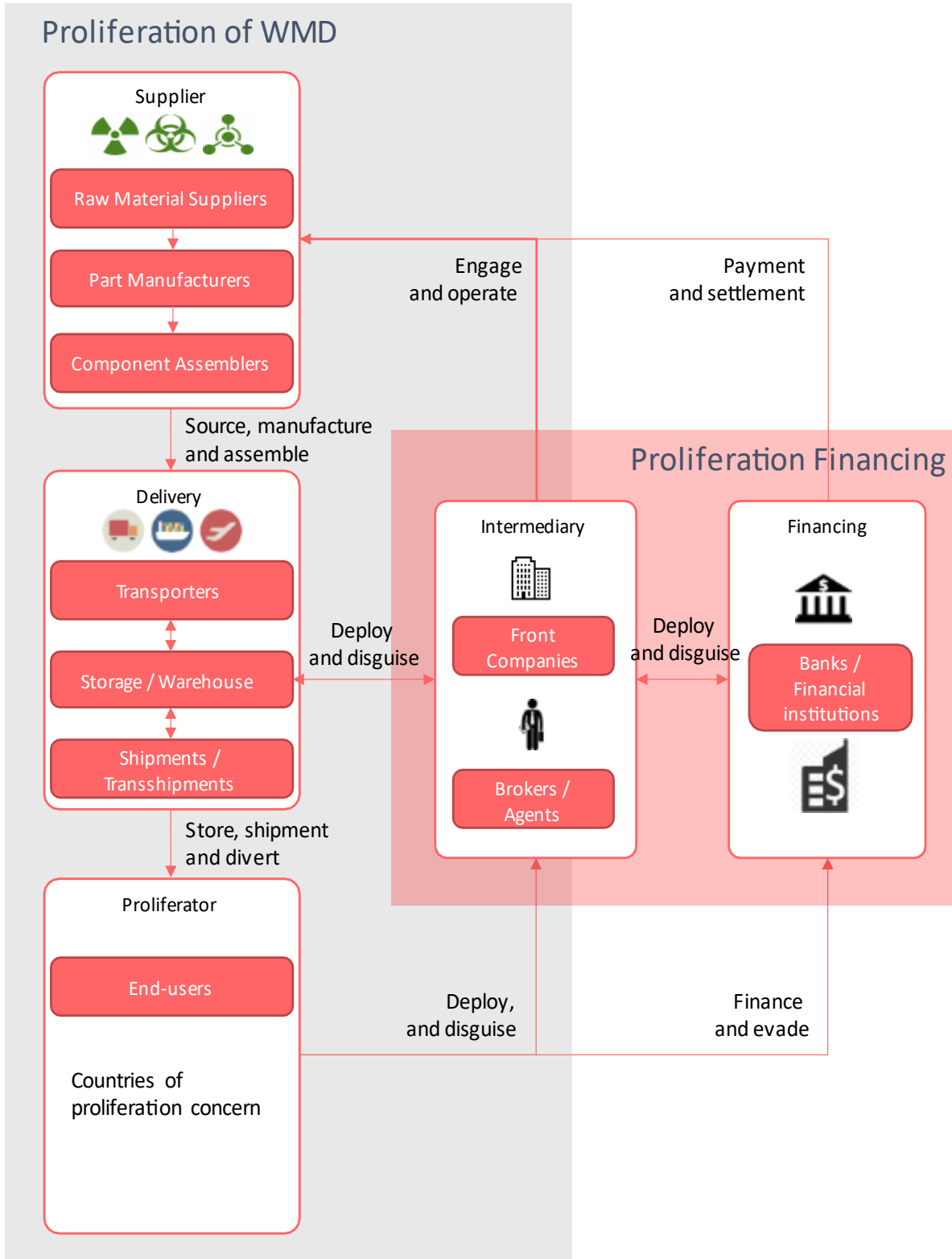
1 Threats, Vulnerabilities & Likelihood

Proliferation of WMD Threats		Likelihood (WMD & PF)
Structural Factors	Support Network	
Sectoral PF Vulnerabilities		
Structural Factors	Support Network	

2 Control Measures

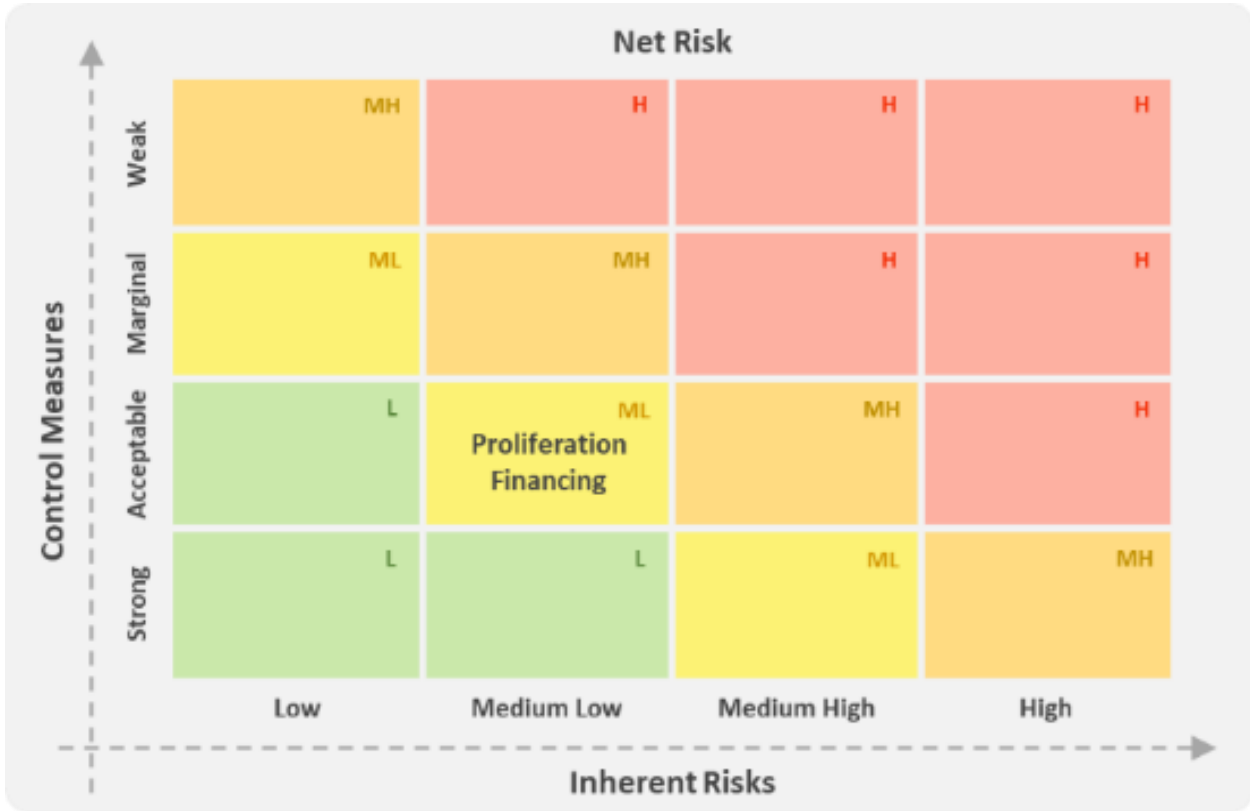
- Legal Infrastructure
- Coordination and Cooperation
- Sectoral Oversight
- Supervisory and Enforcement Actions

EXAMPLE OF MODUS OPERANDI OF PROLIFERATION OF WMD AND PF ACTIVITIES

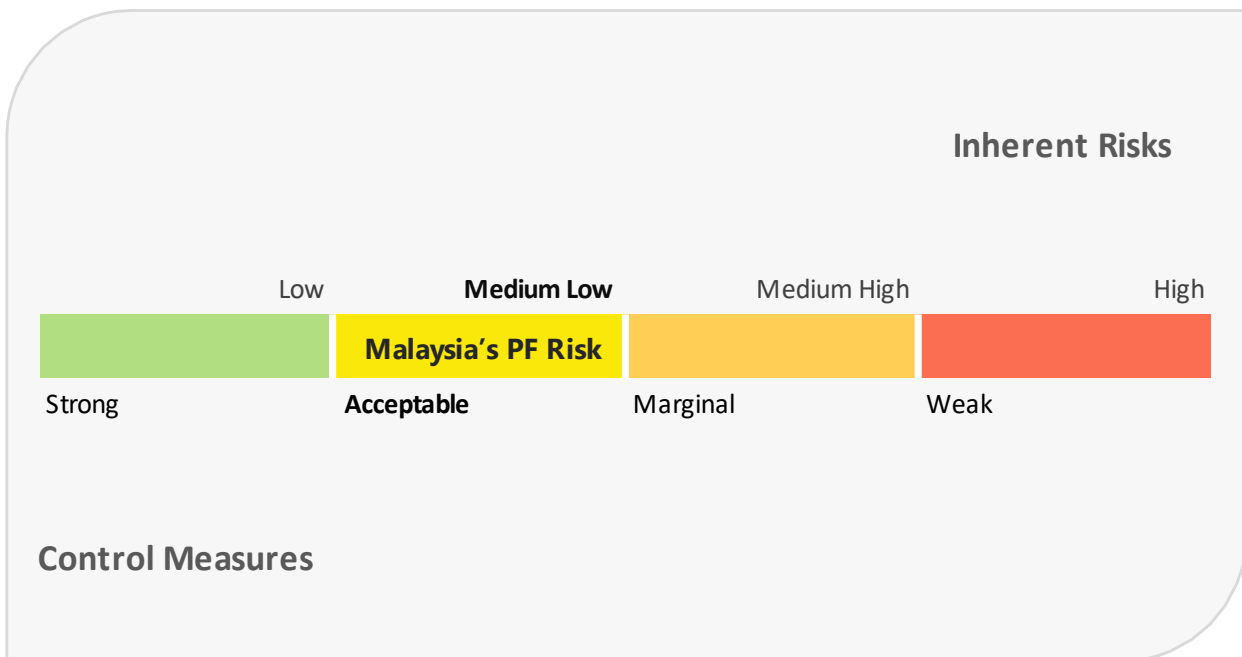


SUMMARY OF FINDINGS

Malaysia's Net Risk for PF [Medium Low]



Overall Inherent Risk [Medium Low] and Acceptable Control Measures



SUMMARY OF FINDINGS



Inherent Risks
Medium Low



Control Measures
Acceptable



Proliferation of WMD Threats

High overall risk for WMD proliferation mainly due to risks and threats emanating from the potential support network, compounded by several structural factors that are assessed as medium to high risks

Country's overall control measures against threats, vulnerabilities and likelihood of P/PF is assessed to be acceptable mainly due to comprehensive legal framework to combat P and PF supported by acceptable level of domestic and international cooperation as well as adequate financial sector oversight

Structural Factors
Geographical Proximity; Country's Accessibility; Trade Environment; Manufacturing Sector; Formation of Legal Persons

Potential Support Network

Legal Infrastructure
WMD Proliferation and CPF



Sectoral PF Vulnerabilities

Low overall PF vulnerabilities risk mainly due to no financial services provided to any UNSC designated person, low exposure to high risk customers, services and sectors

Coordination & Cooperation
Domestic and International

Structural Factors
Financial Centre; High Risk Financial Products & Services; Exposure to High Risk Sectors; Presence in Countries of Proliferation Concern

Potential Support Network

Sectoral Oversight
Financial Sector; DNFBPs; Legal Person; Manufacturing and Trading Sector



Likelihood of P/PF

Likelihood of PF risk is assessed in comparison with crimes assessed under the NRA 2016

Supervisory & Enforcement
Options and capabilities

P/PF Cases
STRs; Financial Intelligence; Enforcement Actions

RECOMMENDATIONS



Legislative, Policy & Coordination Framework

Ensuring robustness of Malaysia's CPF regime while enabling full compliance with international obligations

Salient recommendations include:

- Establishment of national targeted financial sanctions for domestic designation of P/PF-related persons & entities; and
- Assessment on the necessity to criminalize PF as a distinct offence in Malaysia.



Regulatory and Supervisory Initiatives

Increase/enhance supervisory intervention and focus on entities vulnerable to P/PF risks

Salient recommendations include:

- Strengthen market entry control for both financial and non-financial sector; and
- Increase supervisory examination for entities with link to country of P/PF concern (financial & non-financial sector).



Implementation & Compliance

Enhance understanding of PF risk and implementation of sanctions obligations by FIs, DNFBPs and exporters of strategic items

Salient recommendations include:

- Requirement to identify, assess and mitigate PF risk at institutional level; and
- Strengthen sanctions screening program to enable detection of designated persons and related parties.



Enforcement Actions

Enhance/intensify monitoring efforts and enforcement actions to combat P/PF activities

Salient recommendations include:

- Enhance enforcement capabilities to investigate & prosecute P/PF offence; and
- Intensify surveillance monitoring to detect Banks and MSBs potentially facilitating sanctioned person /activity.