



European Banking Industry Committee

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EBiC comments on FATF preliminary report with policy options on proliferation financing

Dear Mr Neylan, dear Mr Sansonetti,

First of all we would like to thank you for the fruitful and open dialogue that we had during the FATF meeting with the private sector on 30 September 2009. We very much welcomed the opportunity to intensify the discussion on potential initiatives of the Financial Action Task Force (FATF) in the area of anti-proliferation-financing requirements for credit institutions. We also would like to thank you for giving EBiC sufficient time to thoroughly analyse the preliminary report and to consult its members.

General Comments

We commend the FATF Project Team on its substantive work and welcome many aspects of the preliminary report. We feel that some key concerns that were expressed by the European banking sector are reflected in the preliminary report. We are pleased that the FATF acknowledges that proliferation financing measures should be proportionate in their impact and cost-effective. In this respect we are glad that the FATF recognizes that financial institutions lack the expertise to discriminate between legitimate and proliferation-sensitive goods and that good lists should not be used as a basis for transaction screening. The report being a good basis for further steps, some parts of it, however, appear still unclear, while other parts continue to give rise to concerns at European banks and their associations.

As consistent international implementation of export controls is a prerequisite for effective proliferation finance measures all FATF member states should focus firstly on (e.g. give a recommendation for) the implementation of such export control systems. Another prerequisite is that jurisdictions worldwide have legal systems in place to ensure that proliferation financing is treated as a serious offence and can be investigated and prosecuted. The final report should stress even more that combating proliferation depends primarily on a functioning export control regime and that additional measures by credit

institutions may easily be duplicative, create confusion and, finally, that in jurisdictions with flawed export control regimes financial institutions cannot help much to alter a state for which the respective jurisdiction is primarily to be held responsible.

European banks regard an entity-based approach (checking lists of natural and legal persons) as the most efficient and cost-effective option when it comes to combating proliferation financing. We are concerned that following the avenue of a risk-based approach beyond such entity-based checks (e.g. activity-based approaches or checking goods, or relying on alleged “risk indicators” or “typologies”, which both do not exist for proliferation financing) could lead to much less effective measures that would simply demand too much from financial institutions and deliver little or nothing in terms of hindering proliferators. Although we understand the rationale for a risk-based approach, we doubt whether with regard to proliferation finance such approach would hold beyond the checking of entities given many uncertainties (above all, financial institutions’ lack of information and knowledge) in relation to the issue. We therefore urge the FATF to apply the principles of efficiency and cost-effectiveness to any further measures it suggests for implementation by financial institutions.

Specific Comments

EBIC would also like to make some more specific comments on the preliminary report.

Definition of proliferation financing and financial services

The term "Financial Services" should be carefully defined (page 10, sub-paragraph 28 and footnote 6). Therefore it would be preferable to adopt a focused definition of "Financial Services" linked to specific proliferation relevant transactions and entities (identified on the basis of the information provided by authorities). When defining proliferation financing it should also be borne in mind that the use of financial services by proliferators is the exception, not the rule.

Responsibilities and capacity of financial institutions to address proliferation financing risks

While we welcome the preliminary report’s affirmation that the scope financial institutions have for establishing "activity-based controls" is "limited" (cf. no. 69 and Annex 3, no. 32), a stronger term would be more appropriate, as "limited" implies that the institutions would indeed have some, albeit constrained, scope. It should, therefore, be stated clearly in the final report that financial institutions actually lack any practicable opportunity to apply an "activity-based" approach. This is true, in particular, for the so-called "red flags" listed in the 2008 FATF Report and, although in a more abstract way, in Annex 3, nos. 18-24 as well as in policy option 18. While such "red flags" may be relevant in some future cases of investigation with the benefit of hindsight (i.e. when examining transactions ex-post), the criminal imagination of proliferators leads us to expect a host of activities so divergent that their categorisation appears impossible. Thus, the recognition of "red flags" is not possible as these are meant to reveal peculiar features today (ex-ante) and not in the future (ex-post). It only illustrates the practical problems of creating "red flags" that the FATF itself has merely listed such examples which (until now) are hardly unequivocal, reliable and "actionable" (in this regard, footnote 13 speaks for itself).

Accordingly, the suggested option of suspicious transaction reporting (policy option 15, nos. 74-77) should be reduced to the reporting of hits based on lists of entities. This focussed approach would also be in line with the principle of cost-effectiveness (cf. no. 20).

Beyond that, our view is that financial institutions should merely have a right to inform when the suspicion is not linked to a hit resulting from the automatic screening of sanction lists. Given the fact that the financial institutions are not experts in arms and dual use goods, an obligation to inform would

indeed result in an overflow of reporting that the authorities would not be in a position to treat and which, in their majority, would not be relevant.

Entity Based Approach- Targeted financial sanctions

While we welcome the acknowledgement of an approach based on lists of entities (cf. policy options 8, 9, 20), two key aspects should be stressed in the final report.

First, such lists should be applied at international level, ideally in the form of UN sanctions. Confinement to national or regional measures, by contrast, would not only open evasion routes to proliferators (cf. nos. 16, last bullet, 57) but also put the financial institutions and exporters of these jurisdictions at an unfair competitive disadvantage vis-à-vis their competitors in other jurisdictions that do not apply such measures.

Secondly, lists of entities should not only contain sufficient information to allow unequivocal identification, but must also be provided in data formats that are compatible with financial institutions' screening tools in order to avoid any bureaucratic burden and the risk of incorrect spelling.

Channels for receiving quality information that is relevant to proliferation financing

Equally important and welcome is the reference in no. 18 to the fact that financial institutions need necessary and sufficient information in order to be able to detect proliferation. In this connection the report also rightly states (in no. 94, cf. also Annex 3, nos. 18 and 19) that banks will not be able to assess the proliferation risk of a country as long as jurisdictions do not provide clear information on such a country's proliferation activity or its weak export controls. Along the same lines, any "ongoing risk-based transaction monitoring" (cf. no. 63) would require "actionable" information or indicators that could be applied 1:1 by financial institutions. By today, all that is "actionable" is, at best, name lists of persons and entities, although the jurisdictions' formats are still not harmonised and financial institutions have to deal with an enormous amount of "false hits" because they lack identifying information. Consequently, relevant (i.e. reliable and useable) criteria and indicators do not merely "contribute" (cf. no. 64) to reasonable anti-proliferation measures by financial institutions, but are a necessary prerequisite for such measures, as is rightly stated in Annex 3, no. 13).

We also approve of the message in no. 49 et seq. that entity-based screening may support combating proliferation. But we would like to stress again that the information provided for this purpose to financial institutions must be "actionable" (which includes the provision of entity data in IT-compatible formats to the banks) and that mechanisms must be in place, including juridical procedures, to avoid financial institutions being drawn into unnecessary discussions with their customers. The latter appears particularly problematic in the case of classified information being shared with financial institutions (cf. nos. 92, 93). The FATF should also make sure that financial institutions will not incur any civil or criminal liability while assisting the authorities in the combating of proliferation financing.

The general reference to, or requirement of, "vigilance" in no. 59 is not helpful. General vigilance is impossible to implement for financial institutions. It must be explained exactly to the credit institutions under which conditions they would have to exercise vigilance. Already the general vigilance requirement in the EU Regulation on Iran is extremely difficult to fulfil by financial institutions.

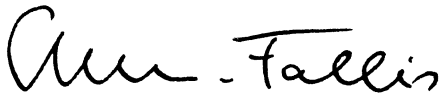
We welcome the clear messages in the report stating that a (comprehensive) "screening of goods" should not be required from financial institutions (cf. nos. 72, 89, 90). We confirm again that banks do not have the practical means to introduce comprehensive checking of goods. However, other parts of the report seem to still assign some value to such an unfeasible approach and may lead to the introduction of the relevance of checking goods through the back door. The ambivalent wording in Annex 3, no. 20, third example, stresses the dual-use quality of goods, at least given other risk factors. As such other risk factors may quite easily be given, the European banks fear that the dual-use issue could come to the

foreground again in spite of the lack of know-how and information access at credit institutions for such checks.

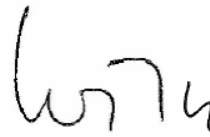
As a technical point, we suggest numbering the policy options throughout the text of the final FATF report to allow easier reading.

We would like again to finally thank you again for your constructive approach and remain at your disposal should you have any further questions.

Yours sincerely,



Karl-Peter SCHACKMANN-FALLIS
EBIC Chair



Udo WITTE
EBIC AML Working Group Chair