

Countering Proliferation Finance: Obama's Legacy and Trump's Challenge

- [Arms Control Today](#)

December 2016

By [Emil Dall](#)

Among them, North Korea will be a top priority, given its threatening posture and the accelerated pace of its missile and nuclear warhead development. Yet, to effectively address this and other proliferation threats, the new administration must also grapple with the underlying processes that facilitate them.



One of these is international finance. Proliferators from former Pakistani nuclear official Abdul Qadeer Khan to the governments of Iran, North Korea, and Syria have used the formal financial system to facilitate their illicit procurement or sales. Without access to sufficient and moveable funds, determined proliferators are unlikely to obtain the sensitive goods and technology they seek. A robust U.S. approach toward countering proliferation finance (CPF) can deny proliferators access to the formal financial system and disrupt related illicit activities.

The United States has been active with CPF efforts for many years, although the approaches taken have varied among administrations. Globally, the conversation is still in its infancy. Some structures, such as limited international obligations, have been put in place to further such efforts. Yet, proliferation financing remains poorly understood; and as a result, government initiatives to combat

it are lacking. This carries ripple effects in the financial sector, where there is confusion as to what should be done to thwart proliferation financing and the best way to do it.

Rectifying these issues is difficult but vital. The international framework surrounding CPF efforts has fallen increasingly out of touch with the reality of proliferation today. Almost counterintuitively, the nuclear agreement with Iran has made it more difficult for the United States to pursue an active discussion on the issue with other governments. The agreement has created the misleading impression that Iran no longer poses a proliferation threat, and the agencies within those governments responsible for countering financial crime no longer perceive proliferation finance as relevant to Iran.

Many of those same countries also feel they are not exposed to risk from North Korea's financial activities because they have not traditionally maintained close trade relationships with Pyongyang. Yet, large North Korean business networks continue to operate overseas, and case studies have shown repeatedly that the country is skilled in carrying out illicit procurement activities undetected around the world.

Proliferation challenges will not be going away, and the establishment of effective policies to counter proliferation financing will be key to ensuring the success of any strategy that seeks to reduce the threat from proliferating actors. The new U.S. president will have to address the current concerns directly and make sure that the conversation on actions moves forward domestically and internationally.

The Early Years

Initiatives to counter proliferation financing have been slow to evolve. The concept first emerged in the early 2000s following revelations that organized networks of determined proliferators were able to procure sensitive nuclear and weapons of mass destruction (WMD)-related goods and technology, in part because of their unregulated access to the international financial system. Khan, a key figure in the development of Pakistan's nuclear weapons program, had supplied sensitive nuclear-related goods and materials clandestinely to buyers such as Iran, Libya, and North Korea until 2004.¹ His complex corporate networks made use of the formal financial system to facilitate deals, routing payments through several middlemen to obscure the nature of the transaction and its parties. The UN Security Council adopted Resolution 1540 in response to these revelations and, in part, to growing concerns that nonstate actors were seeking to acquire WMD capabilities of their own. The resolution text called on member states of the United Nations to prohibit the financing of such acquisition efforts and formed a key part of the George W. Bush administration's counterterrorism policy following the September 11 attacks.²

Then, in 2006 the Iranian and North Korean nuclear issues landed in the UN Security Council. Sanctions packages passed in response included limited measures to counter proliferation financing. They featured targeted financial sanctions against designated individuals and entities central to the two countries' respective illicit nuclear and missile programs and called on all countries to deny these actors access to the global financial system.³

The CPF concept had made its quiet appearance on the international agenda as a consequence of these developments and provided the context for the Bush administration's approach. The approach was guided by a view that the concept merited an international framework, which would outline more explicit expectations of and obligations on states, as well as the private sector, at the front lines of detecting and preventing illicit proliferation-sensitive transactions. The Bush administration was at the forefront of an effort to establish international leadership on CPF issues, according to U.S. and foreign officials.⁴ At a June 2006 meeting with European partners, the administration stated its preference to house such initiatives within the Proliferation Security Initiative (PSI), the intergovernmental initiative spearheaded by the Bush administration to interdict suspected illicit shipments of WMD goods and technology.⁵

As the initiative was already led by the United States, the inclusion of the issue of CPF within its remit would allow for U.S. influence and leadership on the issue. At a later meeting in October with the Group of Seven (G-7) partners, the United States continued to argue for "a more vigorous role"

for the PSI in combating proliferation finance. This view, however, was not shared by all participants. France, in particular, argued that the initiative would not provide a useful home for CPF issues going forward because it could dissuade countries from joining if additional obligations were imposed.⁶

Together with its G-7 partners, the administration instead pursued a plan whereby proliferation financing would be classified as a financial crime risk and housed under the roof of the Financial Action Task Force (FATF), the international organization responsible for coordinating governmental responses to financial crime.⁷ The organization had already been successful in establishing anti-money laundering and counterterrorism financing obligations, and it was hoped that the same could be achieved for CPF issues.

As these conversations with foreign governments took place, the administration devoted few resources to outreach and conversations with financial institutions, which would eventually be tasked to implement international obligations in practice. In many ways, it was too early for the administration to have such conversations with banks, as CPF concepts were still in their infancy on the international stage and most attention was overwhelmingly devoted to terrorism, including countering its financing.

In the final months of the Bush administration, the FATF conducted exploratory research into actions that could be taken by countries to ensure that financial institutions operating under their jurisdictions complied with financial restrictions contained in UN Security Council resolutions related to Iran and North Korea. Its findings were compiled into an in-depth report on proliferation financing, which outlined the trends and tactics employed by proliferators to circumvent the controls of the financial system.⁸ Although this was an important step and the first time that proliferation finance had been devoted attention this exclusively, the task force did not manage to adopt formal CPF measures during the tenure of the U.S. administration that had initiated the discussion. The initiative was therefore left for Obama to take forward.

Obama Administration Efforts

Obama picked up where his predecessor left off in terms of the international CPF discussion, but made key changes in other parts of his approach. Particularly, in the first years of the Obama administration, officials not only wanted stronger obligations to comply with sanctions lists, but were also pressing for obligations to counter proliferation financing activity more generally. This would involve obligations on financial institutions to remain vigilant toward financial transactions that may not be connected to sanctioned individuals and entities but still have a connection to nuclear or missile proliferation activities.

The administration ran a proliferation finance project team within the U.S. Department of the Treasury with the goal of presenting practical policy options to the FATF for how formal recommendations could be established.⁹ Officials also met with European partners ahead of task force plenary meetings to demonstrate a united view on Iran and North Korea. In May 2009, for example, Daniel Glaser, who was then U.S. deputy assistant secretary for terrorist financing and financial crimes, discussed with officials from France, Germany, Italy, and the United Kingdom the possibility of banning all correspondent banking relationships between European and Iranian banks in response to Iranian terrorism financing concerns.¹⁰ Such a ban would also hinder Iran's proliferation finance activities. Officials also reached out to jurisdictions that had notoriously bad track records on proliferation finance. In a July 2009 meeting with the top official at the central bank of the United Arab Emirates, a senior U.S. Treasury official pressed for specific steps to curb the bank's financial relations with Iran, as well as with North Korean front companies operating from the UAE, and made it clear that the UAE's potential FATF membership would be contingent on its actions.¹¹

Not all governments shared the U.S. view that CPF obligations should be activity based rather than limited to sanctions lists only. There was a difference in views between the United States and European partners on this issue.¹² Germany, in particular, worked against the United States on this point. It believed that financial institutions were not in a position to exercise a "general vigilance" against proliferation finance and that placing such additional due diligence measures would be bad for the country's export community.

These conflicting views meant that the agreed mandate within the FATF, although an important step, was much narrower than what Washington had originally envisioned. In 2012 the task force included the issue of CPF in its formal recommendations, focusing only on the implementation of list-based financial sanctions at the UN level.¹³ Countries would only be required to implement UN targeted financial sanctions relating to proliferation, covering Iran and North Korea at the time. Because UN Security Council resolutions form international law already, this did not create any new obligation on FATF members. Because it only covered targeted sanctions, it also excluded UN Security Council Resolution 1540 and its proliferation finance requirements.

There are three problems with this narrower definition, which the new U.S. president must address. First, the recommendation has done little to alter the practices of financial institutions, most of whom have expressed the view that they were already implementing targeted financial sanctions internally without help from governments.¹⁴ Banks employ software programs that screen all incoming and outgoing transactions against sanctions lists in order to flag transactions that involve sanctioned entities. On the whole, financial institutions believe they are already countering proliferation finance by focusing on sanctions alone. The obligation established at the FATF level has done little else than merely reconfirming it as one of the practices that may be employed to counter proliferation finance.

This illuminates a second, practical issue: proliferation finance as an activity goes beyond UN lists of sanctioned entities and individuals. The UN sanctions list for North Korea, for instance, includes 28 individuals and 32 entities, far fewer than are actually engaged in Pyongyang's proliferation endeavors.¹⁵ Proliferators such as North Korea employ various deceptive practices to circumvent such basic scrutiny as sanctions screening software. They almost always use front companies and larger networks to conceal the involvement of designated entities, which will rarely appear on trade or financial documentation after they are sanctioned. Focusing on sanctioned parties at the exclusion of an activity-based understanding of proliferation dramatically weakens overall CPF efforts.

Third, the proliferation financing landscape has developed significantly since the FATF recommendations on CPF issues were concluded, to the extent that the recommendations have been rendered largely irrelevant. Iran, previously covered under the recommendations, is no longer subject to nuclear-related targeted financial sanctions at the UN level and therefore is assumed by some to be no longer within the scope of the FATF recommendations. In the case of North Korea, UN financial sanctions have moved beyond list-based sanctions. For example, financial restrictions now include the banning of correspondent banking relationships with North Korean financial institutions and mandates the closing of overseas branches of North Korean banks.¹⁶ The international standards within the FATF thus lag behind the current reality of counterproliferation regimes and are in desperate need of updating to reflect the new reality.

Obama's Legacy

Little has happened since the inclusion of the topic of CPF in the FATF recommendations in 2012. The United States appears no longer to be advocating for further measures within the FATF, and as a result, the focus on CPF issues within the organization has leveled off. It has not released any CPF guidance since 2013, and a number of other financial crime concerns, such as terrorism financing, are currently prioritized over proliferation finance.



Instead, the Obama administration has pursued stronger actions to counter proliferation finance at the UN level, where recent resolutions on North Korea have included stringent financial restrictions,¹⁷ and at the national level. The administration has consistently supported the tough application of national sanctions on proliferators and their supporting networks. That approach began with Iran and has accelerated dramatically with respect to North Korea as the Iran approach was perceived to have “worked.” The United States introduced secondary sanctions on Iran in 2010, a measure allowing officials to sanction non-U.S. and non-Iranian financial institutions for conducting business with individuals and entities in Iran, thus furthering the reach of U.S. obligations beyond its national borders. If a European financial institution was found to be providing financial services in support of Iran’s nuclear and missile activities, the administration had the powers to remove that institution’s access to the U.S. financial system.

Another example of the unilateral expansion of obligations to counter proliferation finance is section 311 of the USA PATRIOT Act, which allows the administration to designate entire jurisdictions to be of “primary money laundering concern.” This measure has been described as the “nuclear option when it comes to financial sanctions.”¹⁸ The designation prohibits the use of correspondent accounts (foreign banks process U.S. dollar transactions through correspondent accounts held with U.S. banks) on behalf of designated jurisdictions. Banks found in violation may lose access to the U.S. financial system, so many simply choose not to conduct any business at all with designated jurisdictions. In 2011 the Obama administration designated Iran under the act, specifically in response to its illicit nuclear program, a move it appears to have contemplated since 2009 when the option was first mentioned in conversations with European partners. The same designation was brought against North Korea in June 2016.¹⁹

Common to all such unilateral measures has been the slow move away from focusing specifically on sanctioned nuclear and missile activities and a move toward focusing on a range of trade with a particular country. The administration, after pursuing this more comprehensive approach to counter proliferation finance, has therefore broadened the scope of initiatives domestically and internationally.

This blurring of the definition of CPF and what it entails has caused some confusion. Interviews with financial institutions around the world reveal that U.S. authorities on one hand maintain high expectations on financial institutions and believe that these institutions should be capable of implementing measures to counter proliferation finance activity. The administration has backed up this perception by pursuing a policy of penalizing international financial institutions for their past

transgressions. The Obama administration has overseen fines of up to \$8.9 billion brought against international banks that illegally processed transactions connected to Iran through the U.S. financial system. The fines have served to instill a general fear among international financial institutions of being caught up in the U.S. sanctions web to the extent that many now pay more attention to U.S. regulators than to their own home governments.

On the other hand, such expectations have not been reinforced with guidance on the specific measures that financial institutions can adopt. Any formal outreach and communication with banks is focused on sanctions implementation and not efforts to counter proliferation finance. The result is a private sector overly focused on implementing list-based financial sanctions, relating to specific countries, entities, or individuals, rather than proliferation finance activity more generally.

When it comes to engagement with other governments, the Obama administration has continued its outreach activities to countries particularly exposed to threats resulting from proliferation financing, such as in Southeast Asia. In this way, it has ensured that the conversation on the need to counter proliferation finance is continuing in those jurisdictions. What the administration has not done is to further promote activity-based measures, and as a result, many countries have not devoted much thinking to CPF activities beyond mandated sanctions implementation.

Furthermore, although some countries have been motivated to cooperate with the United States on CPF issues because of the fear of being on the wrong side of U.S. sanctions, others perceive the aggressive use of sanctions by the United States as overly wide-ranging and have become less inclined to cooperate for that reason. It is therefore crucial that the new U.S. president pursue measures to make CPF efforts truly international rather than what is currently perceived by many as overreach of U.S. sanctions regimes.

Next Steps



A question facing the new U.S. administration is whether to return to the FATF and pursue a stronger set of CPF recommendations within that forum. The lessons learned from previous administrations will come in useful. The process for affecting change within the FATF is often slow, and the consensus reached is often at the lowest common denominator. Should the administration still want to revive U.S. advocacy to counter proliferation finance within the FATF, it should consider whether it wishes to push for an update to the formal recommendations to make sure these are brought current with the reality of recent sanctions regimes. It should also ensure that resources are devoted to the issuance of specific guidance to countries and financial institutions and bring onboard other governments that may be susceptible to supporting this effort.

Second is the question whether the administration should restore its advocacy of an activity-based discussion on CPF issues. In the latter years of the Obama administration, U.S. efforts to counter proliferation finance appear to have moved away from this discussion, instead focusing on deterring financial institutions from engaging with entire jurisdictions rather than specific proliferation-specific activities. The new administration will need to determine whether it wishes to continue this policy to deter general business relationships on a whole range of activities or to refocus efforts to define proliferation finance activities as those that may be carried out by any actor at any time.

Finally, the incoming administration will need to consider its outreach strategy to financial institutions and governments. Financial institutions are the ones processing payments that may potentially support proliferation activities, and it is crucial that they are given the guidance and tools necessary to detect and stop such transactions. It is also important that they are aware of exactly what is expected of them. Although these expectations should be informed by national governments, the conversation is currently led globally by U.S. expectations. Given that the conversation on CPF is still only in its infancy at the global level, it therefore falls to the United States to engage in more active conversations in order to create a self-sustaining CPF effort in other jurisdictions.

These questions will be difficult to address, but they are vital to ensuring that proliferators will not be able to access the formal financial system to support their illicit procurement activities. All of the gaps and challenges ahead also require international partnership in order to work. The United States cannot be perceived as going alone on this issue because doing so would be counterproductive and ill received. It would be counterproductive because it runs the risk of foreign governments disengaging from the issue, due to the impression that the United States will cover the education, monitoring, and implementation of CPF efforts globally. It would be ill received because many countries already see U.S. measures as overreach, and a furthering of this sentiment could cause some governments to see CPF efforts as a policy only relevant to the United States and its allies. The United States cannot dominate such conversations, and it is important that an international norm is developed around CPF so that others may follow suit.

As outlined above, the Bush administration recognized the need for CPF issues to be treated internationally in their own right. The Obama administration continued this effort and successfully oversaw the inclusion of CPF topics in the FATF recommendations while expanding unilateral measures against proliferating actors. It will be up to Trump's national security team to make sure that CPF efforts are maintained as a priority on the global counterproliferation and arms control agenda and that obligations are pursued in a way that ensures a focus on CPF at an activity level.

Deceptive practices of proliferators evolve in response to new sanctions designations, and it is important that initiatives to counter proliferation financing at an activity level are restarted. The United States will need to push for international standards that acknowledge this and ensure that counter proliferation finance efforts remain a global agenda item, not just a U.S. one.

ENDNOTES

1. Michael Laufer, "A.Q. Khan Nuclear Chronology," Carnegie Endowment for International Peace, September 7, 2005, <http://carnegieendowment.org/2005/09/07/a.-q.-khan-nuclear-chronology>.
2. UN Security Council, S/RES/1540, April 28, 2004.
3. UN Security Council Resolution 1737 froze the assets of designated individuals and entities connected to Iran's nuclear program and installed bans on certain sensitive goods and materials. Resolution 1718 froze the assets of designated individuals and entities connected to North Korea's nuclear program, imposed an arms embargo, and installed bans on sensitive technology.
4. Interviews conducted by author.
5. WikiLeaks, "Public Library of U.S. Diplomacy: French Conference on WMD Proliferation Financing," June 27, 2006, https://wikileaks.org/plusd/cables/06PARIS4443_a.html.
6. WikiLeaks, "Public Library of U.S. Diplomacy: (S/NF) G7 Conference on WMD Proliferation Financing," November 7, 2006, https://wikileaks.org/plusd/cables/06PARIS7269_a.html.
7. Ibid.
8. Financial Action Task Force (FATF), "Proliferation Financing Report," June 18, 2008, <http://www.fatf-gafi.org/media/fatf/documents/reports/Typologies%20Report%20on%20Proliferation%20Financing.pdf>.
9. WikiLeaks, "Public Library of U.S. Diplomacy: U.S.-EU Nonproliferation Consultations," August 11, 2009, https://wikileaks.org/plusd/cables/09STATE83574_a.html.
10. WikiLeaks, "Public Library of U.S. Diplomacy: National Coordinated Measures Meeting with EU4, May 14, 2009," June 8, 2009, https://wikileaks.org/plusd/cables/09STATE58742_a.html.
11. WikiLeaks, "Public Library of U.S. Diplomacy: Treasury A/S Cohen Raises Iran, North Korea, Taliban With UAE Central Bank Governor," August 4, 2009, https://wikileaks.org/plusd/cables/09ABUDHABI783_a.html.

12. Interviews conducted by author.

13. FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations," February 2012, http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

14. Interviews conducted by author.

15. UN 1718 Sanctions Committee (DPRK), "Sanctions List Materials," March 2, 2016, <https://www.un.org/sc/suborg/en/sanctions/1718/materials>.

16. UN Security Council, S/RES/2270, March 2, 2016.

17. UN Security Council Resolution 2270 enforced new measures to terminate financial relationships with North Korean banks located overseas and included restrictions on proliferation finance activity more generally.

18. Hamish Macdonald, "U.S. Lists North Korea as Money Launderer, Imposes Financial Strictures," NK News, June 1 2016, <https://www.nknews.org/2016/06/u-s-lists-north-korea-as-money-launderer-imposes-financial-strictures/>.

Emil Dall is a research analyst in the Proliferation and Nuclear Policy program at the Royal United Services Institute, where he focuses on nuclear and missile proliferation networks, proliferation financing, and sanctions policy.

Source URL: https://www.armscontrol.org/ACT/2016_12/Features/Countering-Proliferation-Finance-Obamas-Legacy-and-Trumps-Challenge