

COUNTERING THE FINANCING OF TERRORISM AND SANCTIONS POST-BREXIT

The focus of Anti-Money Laundering (“AML”) begins with scrutiny on the investor side however, two key developments have emerged on the investment side of due diligence.



First, the Financial Action Task Force (“FATF”) has given a clear indication on how it currently sees Countering the Financing of Terrorism (“CFT”) obligations where Proliferation Finance (“PF”) is a linked priority. Second, Brexit will give scope for the United Kingdom (“UK”) to diverge from European Union (“EU”) sanctions regimes.

CFT

In July 2019, the FATF published the report Terrorist Financing Risk Assessment Guidance. The report is aimed at governments but gives insight into how CFT will develop in industry. The FATF states:

‘While all countries should have a holistic understanding of all stages of Terrorist Financing (“TF”) (raising, moving and use of funds or other assets), this report recognises that there is no one-size fits all approach when assessing TF risk.’

Simply, TF comes in many varied forms. The report recognises ‘car rental, purchasing a kitchen knife’ as types of routine transactional activity caught by the definition. At the other more relevant end of the spectrum, the report also makes recommendations for ‘a developed country with a sophisticated financial sector that is not located anywhere near areas of conflict.’

The key analysis applicable to governments, supervisors and industry whenever required to make an assessment of TF risks is that:

- (a) TF is different from Money Laundering (“ML”). For ML, the generation of the funds is an objective in itself where the source of funds is illicit and the end apparently legitimate. By contrast, in TF, spending is the aim where the funds may begin as legitimate but are being directed to a harmful end;
- (b) Terrorists are adaptable and will vary how they raise and move funds;
- (c) TF and actual terrorism may be linked, but they are far from the same thing; and
- (d) Low volume of funds may be a high risk indicator for TF, but low risk for ML.

In its ‘practical tool’ appendix, the FATF’s report explores a potential vulnerability of a country that has ‘No measures, or inadequate measures, to freeze without delay terrorist funds and assets’. The report states the risk is that such a country would be attractive ‘as a conduit for terrorist financing as the risk of funds and assets being frozen is low.’

Helpfully, the report considers the position of Non-Profit Organisations (“NPOs”). NPOs were singled-out by the Egmont Group in a recent report, as playing a part in 45% of known terrorist financing cases, across a statistically significant sample. In June 2016, the FATF revised its approach to NPOs, reiterating the importance of its risk-based approach because ‘some NPOs represent little or no risk at all.’

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The FATF's report calls for a much more granular approach, and a careful identification of the nature of threats posed by terrorist organisations to NPOs deemed to be at risk, as well as consideration of how terrorist actors abuse those NPOs.

As for the future of CFT, the FATF's report concludes:

'For developed countries with large financial and trade flows, the development of smart solutions in order to cope with "big data" and the continued development of multi-agency information sharing mechanisms will likely be important in ongoing efforts to identify and assess TF risk.'

In summary, though aimed at governments, the July FATF report gives insight into the way global standards on CFT will be interpreted. Risk based approaches in industry will need to distinguish CFT from AML, as will supervision and enforcement at national level.

As for discerning a direction of travel for the FATF, in its thirtieth year, it has taken an expanding remit. In May 2019, the FATF adopted a 'new, open-ended mandate' and turned its attention to mitigating risks from virtual assets, and strengthening its standards on Countering the Financing of Proliferation (of nuclear weapons). China currently holds the FATF's presidency.

Brexit

At present, the predominant sanctions regimes are maintained by the US (via its Office of Foreign Assets Control at its Department of Treasury), the United Nations ("UN") Security Council (which informs regimes of UN member states, sometimes with immediate effect) and the EU. UK sanctions are maintained by its Office of Financial Sanctions

Implementation (at HM Treasury) which maintains a consolidated list of all applicable sanctions, i.e. the sum total of those emanating from the UN Security Council, and those having direct effect under EU law. In the Cayman Islands, by way of further example, its Financial Reporting Authority is responsible for disseminating sanctions applicable in the Cayman Islands, derived from the UK list. The Canadian list of sanctions regimes is maintained by its Office of the Superintendent of Financial Institutions.

In the field of targeted financial sanctions, the UK prior to Brexit is dependent on the EU. The EU provided a mechanism for the UK to discharge its duties as a UN signatory. Without the Sanctions and Anti Money-Laundering Act 2018 ("SAMLA"), the UK could not meet its international obligations post-Brexit. Further, without SAMLA, the UK would lack the means to impose its own sanctions independently of the UN, in all but the most limited counter-terrorist arenas. Nor could the UK amend its existing Money Laundering Regulations, absent SAMLA.

Therefore, the central purpose of SAMLA is to enable the UK to continue to implement UN Sanctions regimes and, additionally, to deploy its own unilateral sanctions to meet domestic national security and UK foreign policy objectives. There will be the option for the UK whether to follow EU regimes. Presumably, UK overseas territories will mirror the UK's path and although the Cayman Islands has the ability to impose its own counter-terror sanctions regimes, it has not done so to date.

Just as there is a general transition period for Brexit, so, in the arena of sanctions, temporary legislation will enable the UK government to amend existing EU sanctions lists for a two-year period. However, this interim power is limited to adding or removing the names of designated persons to existing EU lists. It would be wholly inadequate in isolation, being quickly overtaken by events.

Simply, international targeted financial sanctions are most effective when deployed by a large number of countries, acting in concert to signify disapproval and seek to change the behaviour of another nation or international actor. That said, the US and EU have taken differing approaches to Cuba and Iran in recent history.

For the first time since 1972, the UK and its overseas territories now have the potential to take a different sanctions course from the EU. Whether this route is taken will depend on the incumbent in power at Number 10 Downing Street, and the extent to which he or she wishes to align the UK more with the US than the EU. In theory, the UK could even embark upon a third path of unilateral sanctions, distinct from both the US and EU.

Aside from sanctions, post-Brexit the UK loses its EU mechanism for making regulations for the purposes of AML and CFT. SAMLA also bridges this

legislative gap. Before Brexit, the UK is again reliant on the European Communities Act 1972 to transpose EU Directives on AML and CTF. Ultimately, these Directives were driven by standards and guidance from the FATF. Such powers were used in June 2017 to transpose the Fourth EU Money Laundering Directive and associated Funds Transfer Regulation, which provided a wholesale revision of the UK's 2007 Money Laundering Regulations with even greater focus on adoption of a risk based approach.

As with sanctions, although the European Union (Withdrawal) Act 2018 preserves the UK's AML / CTF regime as at 31 October 2019, the UK needs an additional power to make, amend and repeal relevant regulations by secondary legislation. The lack of a SAMLA type power would prevent the UK updating that regime to address matters including emerging risks and updated international standards from the FATF.

Again, there is the potential for the UK and its overseas territories to take a different path from the EU in the arenas of AML / CFT. This seems more unlikely than in the arena of sanctions, where an individual Minister (or Prime Minister) may make more of an impact with the designation of targets for financial sanctions. By contrast, AML and CFT are driven by global standards emanating from the recommendations and mutual evaluations of the FATF. There is far less scope for divergence here, at the direction of a strong-willed political leader, or otherwise.



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