



UNDERSTANDING PROLIFERATION FINANCING AND WHY IT MATTERS

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**AML/CFT/PF Unit, Licensing and Enforcement:-
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FOREWORD

This article is aimed at raising awareness of the risks and vulnerabilities regarding proliferation financing, and the potential damage if a Securities Market Intermediary knowingly or unknowingly plays an appreciable role in proliferation financing. This article is applicable to all persons and entities regulated and supervised by the Securities and Exchange Commission of Zimbabwe (SECZ) and the generality of investing public who wish to understand proliferation financing and why it is a matter of concern across the globe. The Commission has noted that some individuals find it difficult to understand Guidelines and Notes which explain the proliferation financing and related issues, and as such has come up with this article to ensure that all parties in the Securities Sector understand proliferation financing phenomenon in a simple manner.

ABBREVIATIONS & ACRONYMS

AML	Anti-Money Laundering
CPF	Counter Proliferation Financing
CFT	Counter Financing of Terrorism
DNFBPs	Designated Non-Financial Business Professions
EU	European Union
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
KYC	Know Your Customer
PF	Proliferation Financing
SECZ	Securities and Exchange Commission of Zimbabwe
SMIs	Securities Market Intermediaries
STR	Suspicious Transactions Report
TFS-PF	Targeted Financial Sanctions on Proliferation Financing
UN	United Nations
UNSC	United Nations Security Council
UNSCR	United Nations Security Council Resolution
WMD	Weapons of Mass Destruction

1. What is Proliferation Financing?

Proliferation financing is the act of providing funds or financial services which are used, in whole or in part, for the manufacture, acquisition, possession, development, export, transshipment, 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.¹

The risks posed by weapons of mass destruction (WMD) stem not only from ready-made bombs, nuclear, chemical, or radiological material, but also from dual-use goods and technology that are traded, shipped, and used globally. Almost every single moment, no matter where one finds him/herself in the world, they are surrounded by products that rely on the same technology and material as weapons of mass destruction for example material that is indispensable for laptops and transistors can be used in military equipment.

2. What are Weapons of Mass Destruction (WMD)?

WMD refers to nuclear, chemical, and biological weapons and their means of delivery which poses a threat to international peace and security.²

3. What is Proliferation of Weapons of Mass Destruction?

Proliferation of Weapons of Mass Destruction (WMD) is 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 dual-use technologies and dual use goods used for non-legitimate purposes).³

Some examples of dual use goods include global positioning satellites, night vision technology, thermal imaging, some models of drones, missiles, aluminium pipes with precise specifications or certain kinds of ball bearings, sensors, and lasers among others. Dual-use goods are products and technologies normally used for civilian purposes, but which may have military applications. They can potentially be used as precursors or components of weapons of mass destruction.

1 British Virgin Islands Financial Investigation Agency. (2022). <https://www.fiabvi.vg/Supervised-Entities/What-is-proliferation-financing>

2 <https://www.un.org/counterterrorism/chemical-biological-radiological-nuclear-terrorism>

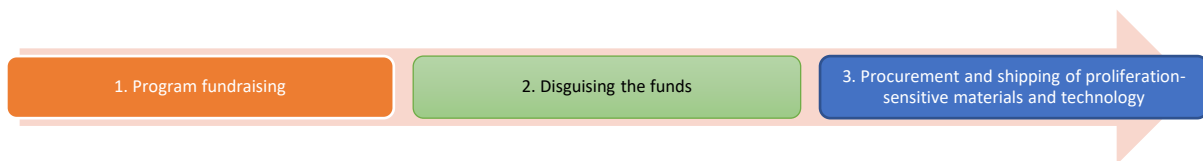
3 Financial Action Task Force (2021), Guidance on Proliferation Financing Risk Assessment and Mitigation, FATF, Paris, France.

<https://www.fatfgafi.org/publications/financingofproliferation/documents/proliferation-financing-riskassessment-mitigation.html>

Without proper safeguards being maintained, and imposed on sensitive materials, technology, services, and expertise, these can become accessible to individuals and entities seeking to profit from the acquisition and resale, or for intended use in Weapon of Mass Destruction (WMD) programs.

4. Stages of Proliferation Financing⁴

The stages of proliferation financing differ from the **placement-layering-integration** cycle associated with money laundering. Rather, the pattern used by proliferators is a **linear Raise – Obscure – Procure & Ship**.



5. What is Proliferation Financing Offence?

A Proliferation financing offence means any criminal offence which constitutes proliferation or proliferation financing under the laws of Zimbabwe, and any criminal offence which constitutes proliferation or proliferation financing under a law of a foreign jurisdiction, in relation to acts or omissions which, had they occurred in Zimbabwe, would have constituted an offence in Zimbabwe.⁵ A Proliferation financing offence relates specifically to the development, production, acquisition, retention, and transfer of nuclear, biological, and chemical weapons.

6. What is The Proliferation Financing Risk?

Proliferation Financing Risk is the potential breach of targeted financial sanctions as directed by the United Nations Security Council resolution 1540 (and its successor resolution), to tackle the proliferation of weapons of mass destruction and its financing. These sanctions include, for example, freezing **without delay** the assets of countries and persons involved in proliferation financing activities.⁶

⁴ Center for a New American Security report on PF. J. Brewer (2018)

⁵ SI 110 of 2021, Suppression of Foreign and International Terrorism.

⁶ Bashir El Nakib (CAMS). (2018). Red Flags indicators on Proliferation Financing. Compliance Alert.

7. Who is a Proliferator?

A proliferator is an individual, group of individuals, or entities that abuse both the formal and informal sectors of the international financial system to drive proliferation activities.

8. How Proliferators Operate?

Proliferators:

- a. operate globally.
- b. mask their acquisitions as legitimate trade; and
- c. exploit global commerce (i.e., operate in countries with weak export controls or free trade zones – where their procurements and shipments might escape scrutiny).

Proliferation Networks are comprised of Proliferators who:

- a. abuse both the formal/informal sectors of the international financial system by using the ordinary financial transactions to pay intermediaries and suppliers outside the network.
- b. use cash to trade in proliferation type goods to circumvent the system.
- c. purchase proliferation-sensitive goods/services in the open market and make them appear legitimate to avoid suspicions of proliferation (i.e., purchase of dual-use goods).
- d. conduct financial transactions in the banking system through false/ legitimate intermediaries, front companies, and illegal trade brokers; and
- e. create complex procurement networks to avoid detection of the true end-users of proliferation-sensitive goods.⁷

9. What are the Targeted Financial Sanctions Related To Proliferation?

Financial Action Task Force (FATF) Recommendation 7.1 direct countries to implement targeted financial sanctions **without delay** to comply with United Nations Security Council Resolutions, adopted under Chapter VII of the Charter of the United Nations, relating to the prevention, suppression, and disruption of proliferation of weapons of mass destruction and its financing.⁸ Securities Market

⁷ Real Estate Advisory Council Botswana. (2020). Guidance Note on Proliferation and Proliferation Financing

⁸ UN Security Council Resolution 1540. (2004). <https://www.un.org/disarmament/wmd/sc1540/>

Intermediaries are required to freeze, **without delay** and **without prior notice**, the funds or other assets of designated persons and entities.

Designated Persons or entities means any person or entity listed on a UN Sanctions List. Designation or listing criteria are:

- person or entity engaging in or providing support for, including through illicit means, proliferation-sensitive activities, and programmes.
- State Actors at the direction of proliferating states (listed on the FATF website);
- person or entity acting on behalf of the designated person; and
- person or entity assisting designated person in evading sanctions or violating UNSCR provisions.

The UNSC has a UN Consolidated List of all the sanctioned individuals, entities, or groups designated by the United Nations Sanctions Committees or directly by the UNSC. This list can be found on: <https://scsanctions.un.org/search/>

Procedure for implementation of UNSCR starts with the Ministry of Foreign Affairs receiving a notice of UN Consolidated List of any addition, removal or other amendment made to the current UN Consolidated List of designated persons. This is followed by the updated list, without delay, is forwarded to the Minister of Finance and Economic Development. When the Minister of Finance and Economic Development receives the UN Consolidated List and directs the Financial Intelligence Unit to disseminate it.⁹

The FIU Director-General, immediately, make an order, of freezing the funds and other assets of the entity or individual or any entity owned or controlled directly or indirectly by any person or entity designated by the UN. The FIU Director-General disseminates and ensure every competent supervisory authority disseminates the UN Consolidated List without delay. An order to freeze funds or other assets remains in force and not lapse until such entity or person has been removed from list by the UN.¹⁰

9 SI 110 of 2021, Suppression of Foreign and International Terrorism.

10 SI 110 of 2021, Suppression of Foreign and International Terrorism

Obligations on Securities Market Intermediaries to implement TFS ¹¹

- a. Subscribe to United Nations Security Council Consolidated List Search or any other relevant websites for update notifications: <https://scsanctions.un.org/search/>
- b. Screening must be undertaken upon any updates to the UN Consolidated List, prior to onboarding new customers, upon KYC reviews to a customer's information and before processing any transaction.
- c. Apply TFS by freezing all funds or other assets **without delay** and prohibition of making funds or other assets or services available when there is a match on screening the clients.
- d. Thereafter forward to the Financial Intelligence Unit "Suspicious Transaction Report" or "Suspicious Transaction Activity", as well as reports or information on all actions taken to freeze the funds and other assets, and any attempted transactions, and the Unit shall make a report to the Minister.

10. Who is Non-state Actor?

A non-state actor is an individual or entity not acting under the lawful authority of any State in conducting activities, which come within the scope of the USCR 1540 Resolution and successor UNSCRs.¹²

11. Proliferation Financing Convention, International Standards and Obligations to Counter Proliferation Financing Risks

Proliferation Financing Convention refers to the United Nations' Security Council's International Convention for the Suppression of the Financing of Proliferation, i.e., United Nations Security Council Resolution (UNSCR) 1540.¹³

❖ The United Nation Security Council's Resolution (UNSCR 1540)

On 28 April 2004, the UN Security Council adopted UNSCR 1540, which was established to prevent non-state actors from acquiring nuclear, biological, and chemical weapons, their means of delivery, and related materials.

- ❖ Under the 1540 resolution, there are those which are targeted, which are the listed on the FATF Websites and their state actors thereto.

¹¹ FATF (2021), Guidance on Proliferation Financing Risk Assessment and Mitigation, FATF, Paris, France.

<https://www.fatfgafi.org/publications/financingofproliferation/documents/proliferation-financing-riskassessment-mitigation.html>

¹² SI 110 of 2021, Suppression of Foreign and International Terrorism.

¹³ Securities and Exchange Commission of Zimbabwe. (2022). AML/CFT/CPF Obligations in the Securities Sector. Training conducted on the 9th April 2022 at Rainbow Towers

- ❖ Under this resolution, there is a broad-based aspect where sanctions apply to other designated individuals, entities or organisation who are not acting independently of any state.
- ❖ The UNSCR 1540 imposed the following two (2) primary obligations upon its UN membership (including Zimbabwe) to restrict proliferation financing. The financial provisions of the Resolution require that all States:
 - a. abstain from supporting non-state actors seeking WMDs and their means of delivery; adopt and implement effective laws (i.e., criminal, or civil penalties for violations of export control laws) to prohibit non-state actors from developing, acquiring, manufacturing, possessing, transporting, transferring, or using nuclear, chemical, or biological weapons and their means of delivery; and
 - b. establish and enforce effective measures and domestic controls (i.e., export and transshipment controls) to prevent the proliferation of nuclear, chemical, or biological weapons, their means of delivery and related materials.

❖ **The Financial Action Task Force (FATF) Recommendation 7**

FATF Recommendation 7, issued to combat proliferation and proliferation financing, states that countries should implement targeted financial sanctions to prevent, suppress and disrupt the proliferation of WMDs and their financing, to comply with the United Nations Resolution UNSCR 1540. The FATF also noted that implementation of the UN resolution would require countries to impose financial services restrictions such as freezing client accounts of named entities or individuals **without delay**, who have been placed on a UN or National Restricted Listing. Further, it emphasized the need for financial institutions to implement ‘preventive measures’ to counter the flow of funds or assets to proliferators or those who are responsible for weapons proliferation. Thus, in accordance with this Recommendation, persons and entities involved in the proliferation of weapons of mass destruction are to be prevented from raising, moving, and using funds, consistent with the relevant UNSCRs.¹⁴

12. Zimbabwe Legislative Framework to Combat PF ¹⁵

- ❖ Suppression of Foreign and International Terrorism Act [Chapter 11:21].
- ❖ SI 56 of 2019, Suppression of Foreign and International Terrorism (Application of 1540 (2004) 1673,1810,1887,1977(On Non-State Actor Proliferation) and successor UNSCRs) Regulations, 2019.

¹⁴ Financial Action Task Force. (2012-2022). International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, FATF, Paris, France.
www.fatf-gafi.org/recommendations.html

¹⁵ <https://www.fiu.co.zw/>

- ❖ SI 110 of 2021, Suppression of Foreign and International Terrorism.

13. Why is it Difficult to Identify Proliferation Financing?

- Dual-use goods are difficult to identify.
- Networks through which proliferation-sensitive goods may be obtained tend to be complex.
- Risk of proliferation financing is more likely to be present in cases where the source of funds is legitimate and the end-user of a type of goods involved is obscured.
- Proliferation financing activity is not limited to individuals and entities designated on sanctions lists.
- Most transactions occur within normal business transaction pathways and can be masked with all legitimate transactions.

14. Proliferation Financing-Threat, Vulnerability and Consequence¹⁶

- ❖ **PF Threat:** PF threat refers to designated persons and entities that have previously caused or with the potential to evade, breach or exploit a failure to implement Proliferation Financing measures in the past, present, or future. Such threat may also be caused by those persons or entities acting for or on behalf of designated persons or entities. It can be an actual or a potential threat.
- ❖ **PF Vulnerability:** PF vulnerability refers to matters that can be exploited by the threat or that may support or facilitate the breach, non-implementation, or evasion of PF-TFS. For financial institutions, vulnerabilities may include features of a particular jurisdiction, particular sector, a financial product, or type of service that make them attractive for a person or entity engaged in the breach, non-implementation, or evasion of PF-TFS, and weaknesses in the financial institution's counter-proliferating financing systems and controls.
- ❖ **PF Consequence:** PF consequence refers to the outcome where funds or assets are made available to designated persons and entities, which could ultimately allow them, for instance, to source the required materials, items, or systems for developing and maintaining illicit nuclear, chemical, or biological weapon systems (or their means of delivery), or where frozen assets of designated persons or entities would be used without authorization for proliferation financing. A breach, non-implementation, or evasion of PF-TFS may also cause

¹⁶ Central Bank of Bahrain (October:2021). Risk Assessment: Guidance for Financial Institutions.

reputational damage to the FI and punitive measures such as sanction designations by the UN and/or relevant authorities. Ultimately, the consequence of proliferation financing is more severe than that of ML or other financial crimes and is more similar to the potential loss of life associated with the consequences of TF.

15. Proliferation Financing Risk Categories¹⁷

Customer Risk

Categories of customers whose activities may indicate a higher PF risk could for example include:

- Those on national lists concerning WMD Proliferation.
- A military or research body connected with a higher-risk jurisdiction of Proliferation concern.
- Any customer or counterparty involved in the manufacture, supply, purchase, or sale of Dual use items, Proliferation-sensitive or military goods.
- A customer who is a small trader/intermediary, who may be a dual-national of a country of Proliferation concern.
- A customer located in a major financial or trade centre.
- Customers involved in the maritime industry, particularly those that own, operate, and/or provide services to ships operating in areas identified as posing a high risk for sanctions evasion.
- A university or research institution with nuclear physics or related technical department with a history of violations of sanctions or export controls.

Country/Geographic Risk

Connections to certain countries may indicate a higher PF risk, for example:

- Commercial ties, or financial relationships with a country that is subject to UN sanctions imposing WMD-related restrictions (Countries listed on the FATF website, or countries in their proximity).
- Business ties, or financial relationships in countries with diplomatic, trade, or corporate links to States of Proliferation concern, or in their close proximity.
- Links with countries subject to other WMD Proliferation restrictions, for example, an “embargoed destination” or other Proliferation concern countries lists.

¹⁷ Jersey Financial Services Commission (2022). Countering Proliferation of weapons of mass destruction and financing. <https://www.jerseyfsc.org/industry/guidance-and-policy/guidance-on-proliferation-and-proliferation-financing/>

- Links with countries presenting on-going and substantial financial crime risks, for example countries with strategic trade controls deficiencies.
- Other relevant factors could include countries with high levels of terrorist activities, corruption, civil unrest, organised crime related to arms dealing among others.

Product/Service Risk

The following may suggest higher PF risks:

- Delivery of services possibly subject to sanctions, e.g., correspondent banking services with institutions subject to UN sanctions.
- Project financing of sensitive industries in jurisdictions of Proliferation concern.
- Trade finance services, transactions, and securities involving jurisdictions of Proliferation concern.
- Transfer of Dual use items, Proliferation-sensitive goods, and materials to a country of Diversion concern. **Diversion** refers to transactions that diverge funds/resources away from their legitimately intended purpose to benefit Proliferators, directly or indirectly.

Delivery channel risk

- Not normally used delivery channels by customers or delivery channels not in line with normal behavioural pattern of the customer.

16. Measures to Counter Proliferation Financing Risks

Some of the risk mitigation measures to counter proliferation financing risks are:

- Improved onboarding processes for customers (including ultimate beneficial ownership).
- Enhanced customer due diligence procedures.
- Effective maintenance of customer master data.
- Regular controls to ensure effectiveness of procedures for sanctions screening.
- Leveraging the existing compliance programs (including internal controls) to identify potential sanctions evasion.

17. How can Proliferation and Its Financing be targeted by Country's Authorities?

There are mechanisms by which proliferation can be targeted; namely export and border controls, financial control vigilance, activity based financial prohibitions, specific vigilance measures and actions

on reporting entities; freezing of assets, international cooperation, information sharing and, and technical assistance.

18. Management of Proliferation Financing Risks

SIMs should manage their potential PF risks by implementing a Risk-Based Approach that incorporates controls to mitigate the risk of PF within their current AML/CFT structure. This could be achieved through:

- applying objective criteria to assess the potential PF risk by using SIMs' expertise and obtaining information from government agencies.
- building on the SIM's existing AML/CFT framework by incorporating proliferation risk factors for consideration along with the wider determination of risk factors.
- using the SIM's established AML/CFT mechanism to conduct risk assessments and identify suspicious activity that is applicable to proliferation considerations.
- implementing risk-based counter-proliferation and proliferation financing policies and procedures, comparable to international standards and training to identify suspicious activity and a system for reporting suspicious transactions; and
- developing and maintaining in-house policies and procedures relative to countering proliferation and proliferation financing and compliance with these proliferation financing guidelines.

A common perception within the financial sector is that proliferation financing controls refer to the implementation of country-specific sanctions, for example, those designed to prevent countries listed on the FATF website from tapping into the global financial system for proliferation activities. However, country-specific sanctions should be seen as integral but not the only part of proliferation financing controls.

19. The PF Perspective to the Securities Market Intermediaries in Zimbabwe

SIMs in Zimbabwe can presume that conventional domestic business with Zimbabwean clients is a near-zero risk of proliferation financing. However, this near-zero risk should be covered by effective application of the institution's general suite of AML and CFT measures. SIMs' employees should also be aware of the red flags for proliferation financing and be able to report any suspicious activity, if necessary.

The general expectation is that SIMs will exercise extreme caution when dealing with countries on the FATF website, UN or EU sanctions lists, or residents of those countries, or transactions associated with

those countries. Most SMIs would do better in risk-management terms to ensure that they are not engaging people or entities that are appreciably exposed to proliferation risks, rather than attempting to manage those risks.

Any SMIs operating internationally, or possessing international clients, who choose to do business with countries with a high-risk profile, will need to know in real time countries that are on the EU or UN sanctions lists, and carefully monitor any connections to those countries, including conducting CDD and EDD, reporting suspicious transactions to the FIU in a timely manner. SMIs should be sensitive to the risks associated with financing the potential tools of proliferation, including nuclear and dual-use material, and military items.

20. Why as a Country Should we be concerned with prevention of PF?

- Proliferation Financing facilitates the movement and development of items that can contribute to global instability and potentially catastrophic loss of life if weapons of mass destruction are developed and deployed.
- Reputational damage for a country or financial market associated with proliferation financing, which may cause investors to shy away from jurisdiction or market perceived as accessible to proliferators.
- A country can be placed under the FATF's grey list or blacklisted for being involved in proliferation financing.
- De-risking of local financial institutions
- Delays in international transactions due to extra scrutiny
- Reduced Foreign Direct Investments (FDIs) & withdrawal of foreign aid

21. Red Flag Indicators and Typologies of Potential Proliferation Financing Risks¹⁸

- The customer is involved in the supply, sale, delivery, or purchase of dual-use, proliferation-sensitive or military goods, particularly to higher risk jurisdictions.
- The customer or counterparty, or its address, is the same or like that of an individual or entity found on publicly available sanctions lists.
- The customer is a military or research body connected with a higher risk jurisdiction of proliferation concern.

¹⁸ FATF (2021), Guidance on Proliferation Financing Risk Assessment and Mitigation, FATF, Paris, France.
<https://www.fatf-gafi.org/publications/financingofproliferation/documents/proliferation-financing-riskassessment-mitigation.html>

- The customer's activities do not match the business profile.
- The customer is vague about the end user(s) and provides incomplete information or is resistant when requested to provide additional information.
- A new customer requests a letter of credit from a bank, whilst still awaiting approval of its account.
- The customer uses complicated structures to conceal involvement, for example, uses layered letters of credit, front companies, intermediaries, etc
- The transaction(s) concern(s) dual-use, proliferation-sensitive or military goods, whether licensed or not.
- The transaction(s) involve(s) an individual or entity in any country of proliferation concern.
- The transaction reflects(s) a link between representatives of companies (e.g., same owners or management) exchanging goods, to evade scrutiny of the goods exchanged.
- The transaction involves the shipment of goods inconsistent with normal geographic trade patterns i.e., where the country involved does not normally export or import the types of goods concerned.
- The order for goods is placed by firms or individuals from countries, other than the country of the stated end-user.
- Countries with weak financial safeguards and which are actively engaged with a sanctioned country.
- The presence of an industry that produces dual-use goods, proliferation-sensitive items, or military goods
- Deliberate insertion of extra links into the supply chain
- Countries that are known to have weak import/export control laws or poor enforcement
- Countries that do not have the required level of technical competence regarding certain goods involved
- The destination or end-user is unclear
- Project financing and complex loans, where there is a presence of other objective factors such as an unidentified end-user
- Declared value of shipment under-valued in relation to shipping cost
- Inconsistencies in information contained in trade documents and financial flow
- The use of fraudulent documents and identities e.g., false end-use certificates and forged export certificates
- The use of facilitators to ensure the transfer of goods avoids inspection
- A freight forwarding firm being listed as the product's destination

- Wire instructions or payment from or due to entities not identified on the original letter of credit or other documentation
- Pattern of wire transfer activity that shows unusual patterns or has no apparent purpose

22. What is the way Forward?

- Accept that proliferation of WMDs and proliferation financing is an imaging problem in the world.
- Conduct risk assessment of customers, products, country/geography, and delivery channels.
- Be alert to the possibility that your customers may be engaging in, or facilitating, proliferation activities.
- Conduct enhanced due diligence and ongoing due diligence on high-risk transactions, clients, and entities.
- Develop situational awareness around various sanctions regimes.
- As soon as practicable, if you know or have a reasonable cause to suspect that a person is a designated person or has committed an offence under any sanction's legislation, complete and submit a STR to the FIU for analysis using the goAML platform.

***Disclaimer:** This article is published for **information purposes only** and is intended to ensure readers understand proliferation financing. Further, the article does not constitute legal advice and is not intended to replace any Act, or any other guidelines, directives or regulations issued by the FATF, FIU or any competent supervisory authority.*

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