Center for a New American Security

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International and Domestic Implications of De-Risking

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Chairman Luetkemeyer, Ranking Member Clay, and distinguished members of the subcommittee, thank you for the opportunity to testify today on the international and domestic implications of de-risking. I applaud your efforts to call attention to the critically important phenomenon of de-risking, something that is not well understood but which has profound impacts on some of the most vulnerable populations. De-risking affects financial inclusion and constitutes an impediment to development. It is particularly disconcerting as it directly affects humanitarian assistance to those most in need, and at a time when those needs are growing. The U.S. has a unique role to play in addressing de-risking globally, as the dominance of the U.S. dollar and American regulatory policies set the stage for other countries regardless of where transactions take place.

My comments today, focused primarily on the impact of de-risking on charities and nonprofit organizations (NPOs)[1] are based on the research I conducted for the February 2017 report, *Financial Access for U.S. Nonprofits,* commissioned by the Charity & Security Network (C&SN) and supported by the Bill and Melinda Gates Foundation. While I am currently involved with the World Bank/ACAMS Initiative on Financial Access for NPOs, the views I express today are my own.

Financial tools, in particular, Anti-Money Laundering (AML), Countering the Financing of Terrorism (CFT), and international sanctions policies, have become essential instruments in protecting the integrity of the global financial system and promoting international security. In recent years, however, the unintended consequences of these policies on some developing countries and certain sectors such as money service businesses (MSBs) and humanitarian organizations have become apparent. Anecdotal examples regarding the significant challenges charities face when financial institutions terminate or restrict business relationships to avoid rather than manage risk abound. Without the ability to transfer funds internationally, NPOs are unable to deliver vital humanitarian and development assistance.

[1] The term nonprofit organization (NPO) has been defined by FATF as: "A legal person or arrangement or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of "good works."

Drivers of de-risking

De-risking is a complex phenomenon driven by the multiple considerations and calculations by financial institutions. Among these various drivers are concerns for reputational and liability risk, profitability, business strategy, the cost of implementing AML/CFT/sanctions and other regulatory requirements, and exposure to penalties by supervisory and law enforcement authorities.

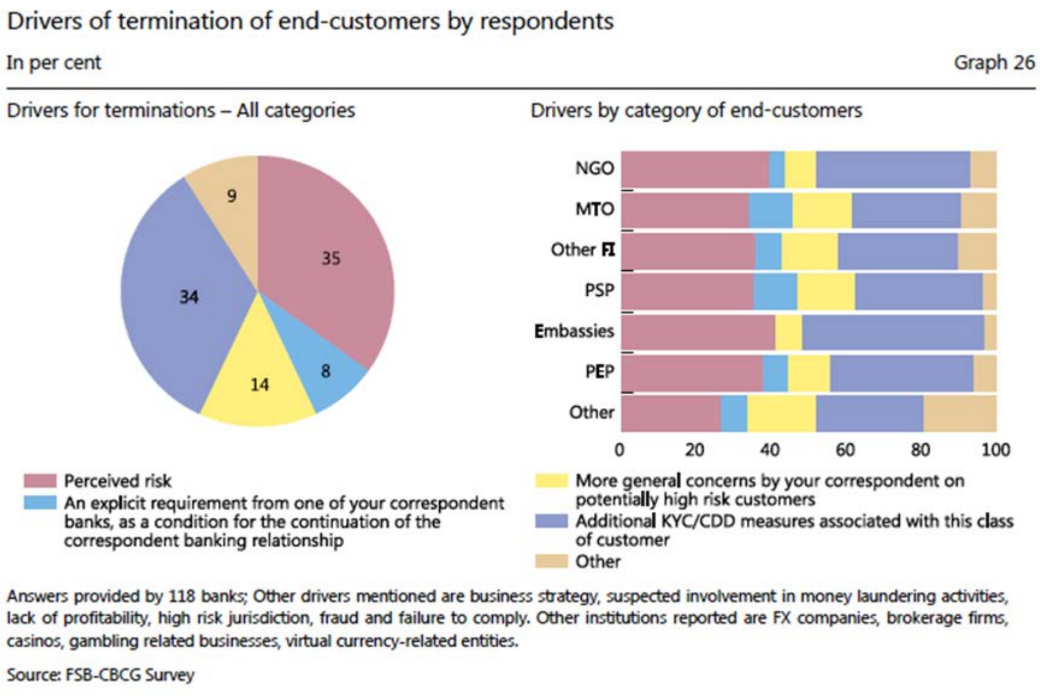
Compliance-related concerns by banks and regulatory expectations are among the most frequently cited reasons for de-risking. For many financial institutions, decisions to decline to provide financial services relate to perceptions that certain customers such as NPOs are high-risk, and certain countries (subject to sanctions or where non-state armed groups such as ISIS and al Shabaab are active or exercise territorial control) are high-risk jurisdictions. Such locations are often the places where humanitarian and development NPOs operate, creating compliance challenges for banks in facilitating transactions to these regions. Regulatory requirements and expectations, as well as routine second-guessing by examiners of financial institutions' decisions require banks to undertake extensive and expensive efforts to mitigate risks and justify decisions, frequently tipping the risk–reward scale toward exiting such relationships. Despite statements from government officials, financial institutions perceive a clear disconnect between what policy officials say and what happens at the individual bank examination level. This reluctance has been fueled by a fear of penalties.

In recent years, several major banks have had large fines levied for AML/CFT/sanctions violations; many financial institutions are still under deferred prosecution agreements or consent orders requiring substantial compliance reforms and costly monitoring which has had a deterring effect on other banks. In the aftermath of the 2008 financial crises, U.S. regulators (on both the federal and state levels) cracked down on regulatory violations, imposing unprecedented fines. Over the last 15 years, both the number and value of AML-related fines have increased in both the U.S. and the U.K.

The upward trend in U.S. enforcement actions and fines against banks, along with the existing regulatory complexity in the AML/CFT/sanctions field, result in significantly increased compliance costs for financial institutions. Financial institutions consistently note that decreased profitability resulting from the increased monitoring and compliance costs of AML/CFT regulations as a key driver of de-risking. Some reports place the additional burden at upwards of $4 billion annually. One bank reportedly employed 4,000 additional compliance staff in one year, at a cost of $1 billion. According to a 2016 survey by the Association of Certified Money-Laundering Specialists (ACAMS), three-fifths of respondents cited enhanced regulatory expectations as the greatest AML compliance challenge. Supervisory actions including personal liability of compliance officers for regulatory violations further contributes to escalating costs and challenges. This trend is not limited to the U.S.; a 2015 survey of Commonwealth members identified decreased profitability resulting from the increased monitoring and compliance costs of AML/CFT regulations as a key driver of de-risking. Added to this is the fact that NPO accounts are not usually hugely profitable.

Countries base their AML/CFT frameworks on international standards established by the Financial Action Task Force (FATF). Central to the 40 recommendations issued in 2012 is the risk-based approach that calls for financial institutions to establish systems to assess client risk and adopt measures to mitigate those risks. When considering the potential risks posed by customers, banks need to take appropriate steps to identify and assess their money laundering and terrorist financing risks (for customers, countries or geographic areas; and products, services, transactions or delivery channels). Financial institutions are required to have policies, controls, and procedures that enable them to effectively manage and mitigate the risks that have been identified. Since the introduction of the risk-based approach, however, regulations have not fully incorporated it so financial institutions can effectively implement a risk-based approach; the result has been persistent termination or restrictions on relationships with countries or customer categories to avoid rather than mange risks. Numerous studies have shown that de-risking has impacted correspondent banking, MSBs, and NPOs' transactions, among others, posing a threat to financial connectivity, financial inclusion, and financial transparency.

Significant analysis has been undertaken on the decline in correspondent banking by the World Bank and the Financial Stability Board. Such reports confirm reduced correspondent banking relationships are also pressuring NPOs and MSBs. The Financial Stability Board in 2017 collected information on the motives behind respondent banks' decisions to terminate services to customers, including NPOs, money transfer operators, payment service providers, Politically Exposed Persons, and other financial institutions. The main drivers reported were the perceived risk (35%) or the "additional KYC (Know Your Customer) or CDD (Customer Due Diligence) measures" associated with these customers (34%) and therefore presumably related to AML/CFT deficiencies, whether detected or apparent.



De-risking of NPOs

Over the past several years, numerous reports document the consequences of financial access problems for de-risked communities, with most focusing on correspondent banking and, to a lesser extent, MSBs. While anecdotes concerning difficulties charities experience have been growing, there had been no solid data available concerning NPOs' problems accessing banking services, save for an indicative survey in 2014 of U.K. charities by the Charity Finance Group.

Moving beyond anecdotes, *Financial Access for U.S. Nonprofits*, released in February 2017 presented the first empirical data as to the scope and nature of problems NPOs encounter. The study was both qualitative and quantitative, including interviews and roundtables with all stakeholders – policymakers and regulators, financial institutions, and NPOs, as well as a random sample survey of U.S. NPOs, designed and conducted by the Schar School of Policy and Government at George Mason University (which entailed telephone interviews of 305 charities; findings were determined to be valid within a 5.4% margin of error).

The report's surprising results paint a picture of a far more pervasive problem than expected, affecting many kinds of NPOs operating in all parts of the globe.[2]

[2] See Appendix A for the Executive Summary and Data Highlights of the report, *Financial Access for U.S. Nonprofits*

Among the report's major findings:

- 2/3 of all U.S. nonprofits that work abroad are having financial access difficulties
- 15% of nonprofits report having these problems constantly or regularly
- Delays in wire transfers, which can last up to several months, are the most common problem, affecting 37% of nonprofits
- One-third of NPOs have experienced fee increases, and 26% have faced additional, unusual documentation requests
- Account closures represent 6% and refusal to open accounts 10% of NPOs, but often can have devastating effects
- Transfers to all parts of the globe are impacted; the problem is not limited to conflict zones or fragile and failing states
- Smaller NPOs, often the last mile in delivering essential assistance, are more likely to encounter delayed wire transfers, fee increases, and account closures
- When money cannot be transmitted in a timely manner, 42% of nonprofits resort to carrying cash and nearly 30% use money remitters

The report concluded that international banking difficulties constitute a "serious and systemic challenge for the continued delivery of vital humanitarian and development assistance," a core component of U.S. foreign and security policies.

As further evidence of the growing problem of NPO de-risking, a new study released in March of this year by the U.K. Charity Finance Group found that 79% of British charities face difficulty in accessing or using mainstream banking channels. The same number of respondents also said that banks had become "substantially or slightly more risk averse to them." Moreover, an increasing number of reports in the past several years document the problems and effects of limited financial access for NPOs.[3]

Essential role of NPOs and impacts of de-risking

The U.S. NPO sector is extremely diverse, ranging from large regional, national or international charities to small, community-based organizations offering a wide variety of programs and services. Research institutes, churches, and professional associations are among the many types of NPOs that typically depend, in whole or in part, on donations, dues or voluntary service for support. The IRS recognizes more than two dozen types of NPOs, with charities making up the largest category of exempt organizations.

The charitable sector provides essential services, complementing government initiatives to assist those in need, often in high risk areas, conflict zones, and inaccessible regions. NPOs' charitable activities help to meet vital humanitarian and development needs. The U.S. recognizes and supports the crucial role of charity in communities worldwide, and views provision of financial services to NPOs to be in the public interest and consistent with AML/CFT goals. Many NPOs, in fact, play critical roles in fighting conditions conducive to terrorism, reducing the appeal of

[3] See Appendix B for a list of reports related to NPOs and financial access challenges.

terrorism by building social structures and increasing intercommunity dialogue and understanding. Inadequate financial access and/or delayed transactions due to concerns for regulatory risk can undermine U.S. foreign and security policies.

Financial services are essential for NPOs to be able to operate safely, effectively and transparently. When NPOs are unable to access banking services, charitable funds may go underground, through increased cash transactions and off-shore cash couriers, or alternative remittance systems. The use of cash, particularly in higher-risk jurisdictions, creates safety concerns for NPOs and their staff and make it more difficult to ensure that funds reach the intended recipients.

There are also additional concerns that de-risking may result in increased flows of informal money. The U.K. reported circumstantial evidence that greater use of cash and other unconventional channels have resurged in some places as a possible consequence of de-risking of NPOs. AML/CFT objectives of transparency and traceability are undermined if financial transactions are driven outside of regulated channels into untraceable banking alternatives.

When NPOs are turned away as customers, have their accounts closed by financial institutions, or experience delays or denials of wire transfers, serious complications result for the delivery of critical humanitarian assistance to countries such as Syria, Somalia and other conflict areas. The 2016 *Study of the Humanitarian Impact of Syria-Related Unilateral Restrictive Measures* documented the "chilling effect" of the private sector's reluctance to support humanitarian activity, particularly by the financial sector fearful of penalties for inadvertent regulatory violations.

Examples abound regarding deleterious impacts of financial access difficulties. One NPO sought to transfer $2m from the US to UK to cover costs for a Syrian winterization project. It was delayed and ultimately denied after 6 months; the inability to transfer funds caused significant operational challenges across the global organization because of the shortfall in cash resulting, not to mention the broken trust and danger to staff created for the field office because they are in arrears with the vendors. In another case, a wire transfer (via Turkey for a hospital in Aleppo) was delayed by 6 months in spring 2017. By the time the transfer was processed, the siege was over. Lengthy delays in transmitting funds to pay for fuel to power a Syrian hospital reportedly resulted in the hospital running out of fuel, leading to severe health complications and suspected fatalities. Funds were denied for two clinics in Lebanon for Syrian refugees that ultimately resulted in the closure of the clinics. In Sudan, a license expired before funding for a Sudanese orphanage program was complete. The NPO was told to suspend operations pending renewal of the license, which took 5 years to approve food, shelter, and medical care at the orphanage. There have been instances where flights for UN food drops have been loaded and are grounded on the tarmac waiting for payments to be approved before being allowed to take-off, which could have a knock-on effect of endangering the awarding of future contracts to customers involved in UN activities.

Financial access problems have also created a chilling effect on donors and fundraising, increased compliance costs and challenges, and resulted in limitations on humanitarian assistance programming, not based on need but rather on where banks will transfer funds. "Because of the possibility of serious delays or cancellation, we have to pick programs that will do least damage if operations are suspended. This excludes some of the most important programs related to development and assistance." One NPO reluctantly decided it would no longer be able to support Sudanese orphans because of financial access-related issues: "In trying to prevent money laundering and terrorism finance, restrictions on sending money are resulting in the death of persons, particularly the victims of terrorism." Moreover, the use by banks of commercial data providers such as World Check and Lexis Nexis to fulfil KYC and DD requirements has been highly problematic with these services producing a high number of false positives. Banks concede that there are deficiencies in these commercially available risk-profile databases.

At the same time NPOs' abilities to access the financial system have been hampered, the level of humanitarian need worldwide has reached unprecedented levels. Violent conflicts, climate disasters, and political repression have generated the largest number of displaced persons since World War II. The UN Office of the Coordinator for Humanitarian Affairs (OCHA) reports more than 135 million people across the world will need humanitarian assistance and protection in 2018, an increase of 5% from 2017. Emergencies in Syria, Yemen, South Sudan, Iraq and Sudan, as well as long-term crises in Somalia, Pakistan, and elsewhere have increased the demand for humanitarian and development assistance, yet the very countries in most dire need of support are among those to which NPOs are having the greatest difficulties in receiving/transferring funds. Just last week, the United Nations reported that the number of hungry people in the world has risen for the first time in more than a decade, with approximately 38 million more undernourished people, rising to 815 million in 2016, the year for which the latest statistics are available. According to the 2018 UN Sustainable Development Goals report, conflict is now one of the main drivers of food insecurity in 18 countries.

Outdated perceptions of risk associated with NPOs

The problems many NPOs experience today stem from action taken in October 2001 by the FATF, whereby protection of the NPO sector from terrorist abuse became a component of the global fight against terrorism. In adopting Special Recommendation VIII (R8), FATF identified NPOs as "particularly vulnerable" to terrorist financing abuse, calling on countries to ensure that NPOs cannot be misused by terrorist organizations. Over time, however, the FATF refined its standard, acknowledging the changing threat environment and the development by the NPO sector of standards and initiatives to ensure accountability and transparency in their operations. In 2014 and 2015, FATF guidance explicitly stated that legitimate charitable activities should not be disrupted or discouraged, clarifying the subset of NPOs that required greater attention - NPOs engaged in service activities and operating "in a close proximity to an active terrorist threat." FATF warned that:

> "Financial institutions should also not view all NPOs as high risk. Most NPOs may face little, if any, risk of terrorist financing abuse. For example, financial institutions should not view NPOs as high risk simply because they may operate in cash-intensive environments or in countries of great humanitarian need."

According to FATF, a "one size fits all" approach to NPOs, whether it comes to supervision and monitoring of NPOs, or how banks manage business relationships with NPO customers, is not appropriate.

Reflecting the decreased risk associated with NPOs, FATF revised R8 in 2016, recognizing that not all NPOs should be subject to the same measures, especially "where humanitarian needs are acute and where charitable work contributes positively to the fight against regional and global terrorism." Subsequent national terrorist financing risk assessments also reflect the lower risk of abuse of NPOs. The U.K. National Terrorist Financing Risk Assessment noted:

> "In comparison to the overall size of the UK charity sector, the amount of known abuse for terrorist financing is very low. It is unlikely that charities have been set up for the purpose of funding terrorism. As such, we now assess the risk of abuse of NPOs altogether for terrorist financing as low, with certain parts of the sector facing significantly higher risks."

Similarly, the 2015 US risk assessment referenced sham or front organizations as the greatest threat to the nonprofit sector, rather than legitimate NPOs.

The outdated and overly broad view of the terrorist financing risks associated with the NPO sector persists, however, notwithstanding changes to FATF R8 to remove the "particularly vulnerable" language and call for a proportionate risk-based approach. In fact, most governments have not issued new regulatory guidance reflecting FATF's revision of R8 or even national assessments of risks related to NPOs; only 1 country assessed by the FATF under the revised standard as of May 2018 was found to be compliant with Rec 8 - Canada.

Furthermore, there is a pervasive lack of understanding of the charitable sector in general, and unfamiliarity with the NPO business model. Many banks and regulatory officials are unaware of the risk assessment and due diligence measures NPOs routinely undertake, not only to comply with sanctions and CFT regulations, but also to account to donors and manage risks to operations and employees. The fact that NPOs are subject to a complex system of regulation and oversight at the federal, state and local levels, and required to register and be monitored by the IRS and state authorities is not well-understood. In addition to reporting requirements, many NPOs also adhere to voluntary self-regulatory standards and controls to improve individual governance, management and operational practice, beyond internal controls required by donors and others. These regimes primarily regulate raising, spending and accounting for funds, seek to protect the public from fraud, and encourage charitable giving. NPOs receiving federal grants undergo additional review by grant making agencies to comply with standards required by OMB (e.g. Agency for International Development recipients are subject to rigorous scrutiny, compliance, and independent auditing requirements).

Without change to the Bank Secrecy Act or the AML Bank Examination Manual or new U.S. regulatory guidance, it's not surprising that financial institutions continue to consider NPOs categorically as high-risk, a view reinforced by examiners. International transfers to certain countries (those subject to sanctions) are viewed with extreme caution: numerous NPOs report that any request involving a reference to Syria (e.g. assistance destined to Syrian refugees in Turkey or Lebanon) has become a red flag, even for NPOs that have secured necessary government approval or licensing for such activities. Several charities aiding Syria report wire transfers being denied and even closure of their bank accounts.

To reassure banks, government officials have issued statements noting that the charitable sector as a whole, does not present a uniform or unacceptably high risk of money laundering, terrorist financing or sanctions violations. In the U.S., policymakers urged banks to apply due diligence obligations reasonably, "not that they be infallible in doing so". However, the fact that there have been no changes to regulations or guidance to encourage financial institutions to update their risk assessments of NPOs ensures that de-risking of NPOs will continue. Without action by government, financial institutions will continue to be reluctant to bank NPOs.

Responses to date

As de-risking is an international phenomenon, various governments have attempted to address concerns of NPOs in a variety of ways over the past several years. In cases of sanctions, the U.S. has amended general licenses for NPOs engaging in humanitarian activities (e.g. Syria, Somalia, and Sudan). Within the European Union, the Syria regulation and FAQs have been issued to clarify the applicable legal framework and encourage the reliance on the humanitarian derogations in the Syria autonomous sanctions. These measures relate to licenses to facilitate the delivery of aid, but do not address bank payments specifically.

Of particular note, however, over the past year and half, multi-stakeholder initiatives have been organized to bring together government, financial institutions, and charities to address the serious effects NPOs have experienced. These initiatives are relatively recent and while encouraging, results have been limited to date.

In 2016, the World Bank and ACAMS (Association of Certified Anti-Money Laundering Specialists) convened the *Stakeholder Dialogue on De-Risking* with more than 100 participants from government (policy, regulatory, and law enforcement authorities), international organizations, financial institutions, and NPOs to discuss the phenomena of de-risking and how to address it. Until then, most de-risking discussions had focused primarily on challenges of correspondent banks and MSBs, but the dialogue noted the significant difficulties humanitarian organizations and charities were experiencing with financial access.

In recognition of the importance of supporting critical humanitarian and development work globally, the World Bank/ACAMS organized a second Dialogue (*Supporting Financial Access for Humanitarian Organization and Charities*) in January 2017 to foster relationships between NPOs, financial institutions, and government; improve the regulatory and policy environment; and develop tools to facilitate understanding and information-sharing. As a result, four workstreams were organized and initiatives are ongoing to:

- provide guidance regarding the type of information banks require to conduct due diligence on NPO customers, and develop training programs/resources;

• propose amendment of the Bank Examination Manual to implement FATF R8, consider options for specialized payment channels for humanitarian crises when the traditional banking is unable to move funds, and explore improvements in humanitarian licensing and exemptions;
• explore technological solutions to facilitate NPO access to financial services, particularly transfers to areas of higher risk and help lower the cost of compliance with CDD requirements in banking NPOs (e.g. NPO KYC utility), and
• promote greater understanding of NPOs and broader financial access challenges though online resources and outreach

A further World Bank/ACAMS stakeholder meeting took place in Washington, DC in mid-June to discuss the lack of progress in addressing financial access problems, while NPOs' difficulties appear to be worsening.

In addition, and in partnership with the Dutch Ministry of Foreign Affairs and the Human Security Collective (HSC), the World Bank/ACAMS convened an *International Stakeholder Dialogue: Ensuring Financial Services for Non-Profit Organizations* in The Hague in February 2018 to discuss comparative approaches to the NPO de-risking challenges.

Multi-stakeholder dialogues have also taken place in the Netherlands and the United Kingdom. In October 2017, the Human Security Collective hosted a sessionto discuss the financial access experiences of Dutch NGOs, the requirements on and concerns of financial institutions, and perspectives of the Ministries of Finance and Foreign Affairs. The meeting was the first in a series to explore possible solutions for stakeholders. Dutch stakeholders appear interested in identifying tailor-made solutions for different types of NPOs. In the U.K, various initiatives by UK Finance (formerly the British Bankers Association) and the Disasters Emergency Committee (DEC) over the past several years have attempted to address aspects of financial access problems of NPOs, especially concerning humanitarian aid to Syria with limited success. A British multi-stakeholder initiative has been meeting since late 2017 to address problems and operating risks facing INGOs in high-risk contexts, such as Syria and Somalia where the delivery of essential humanitarian assistance and development and peacebuilding activities are challenging. Three sub-groups working on the topics of Guidance and Legislation, Training and Best Practices, and Innovation and Information Sharing (including technological solutions) are exploring possible solutions.

Potential solutions

While multi-stakeholder initiatives are in the early phases of developing possible solutions, financial access problems continue, and for some, appear to be worsening. These multifaceted problems arise as a result of multiple but equally compelling policy objectives – to protect security and the integrity of the global financial system from illicit finance and counter terrorism, and to advance foreign policy goals of development, democracy and humanitarianism by providing aid to people in need.

To effectively address the challenges of financial access, all stakeholders must work together in a concerted manner; viable solutions will be found only when the problems are viewed as a shared responsibility of all. There is no single clear-cut solution that will resolve such a complex issue but rather a series of issues that need to be investigated in multi-stakeholder settings. Following are general categories of actions that could usefully be explored but is by no means complete.

<u>Raise awareness and promote a balanced approach</u>

To enhance understanding by banks and governments of NPOs, and by NPOs of regulatory requirements and expectations, enhanced engagement and interaction among all stakeholders is necessary. All stakeholders must recognize humanitarian and development assistance as a priority and take steps to work together for a shared view that ensures balance between mitigating sanctions and terrorist financing risks and facilitating the movement of funds necessary to deliver vital assistance.

Some financial institutions have made special efforts to bank charitable groups operating in sanctioned countries, developing specific guidance. Likewise, many NPOs have adopted self-regulatory measures to ensure accountability, effective control, and transparency in their operations. Sharing information about risk mitigation procedures can help to build mutual confidence and understanding that may reduce questions and problems with financial transactions. NPOs and banks should deepen their engagement with one another, and governments should take a leadership role at national and international levels in seeking solutions. Consideration should be given to raising the issue systematically within other multilateral fora such as the G20.

<u>Provide regulatory and policy guidance</u>

Governments should develop policy and regulatory guidance that provides greater clarity to banks and NPOs on the implementation of the risk-based and proportional framework. Statements that NPOs are not by definition high-risk customers are helpful but insufficient to change financial institutions' willingness to bank NPOs. Revision of the BSA-AML Manual to implement FATF Rec 8 is necessary for financial institutions to change their outdated but persistent perception of NPOs as inherently high risk and to effectively implement a risk-based approach to banking charities. As part of the World Bank/ACAMS initiative, banks and NPOs jointly developed a proposal to revise the existing manual, a testament to the potential of multi-stakeholder strategies. The proposal is currently pending review by regulatory agencies.

Development of better guidance and risk tolerance standards so banks have a clear understanding of regulatory expectations concerning due diligence are important. Guidance and standards must be consistent, practical, relevant to today's financial services market, and proportionate to any actual risk identified, and implemented by examiners. They should clearly outline what information is required to ensure legal compliance by both banks and NPOs while remaining flexible enough to adapt to various types of financial institution and NPO customers. This can lower compliance costs, differentiate between different levels of risk and focus scarce resources on reducing real risks.

Explore incentives for financial institutions to bank NPOs

A menu of measures, including the creation of a safe harbor to incentivize banks to keep NPOs accounts and encourage efforts to engage with NPOs, should be developed. Monetary incentives, such as tax credits, reputational incentives, or recognition of financial institutions who engage in—rather than avoid—effective risk management of NPOs could be explored. A mechanism for NPOs to pool accounts might also provide incentives for banks by streamlining administration and lowering costs.

Measures whereby financial institutions that bank NPOs in good faith and meet certain criteria would be held harmless if funds inadvertently end up in the wrong hands should be considered. The miniscule risk that funds are mislaid is outweighed by the need to ensure that aid is delivered to conflict areas in order to build resilience against terrorism Safe harbor measures would provide banks confidence that they can do business with NPO customers if they maintain rigorous risk-mitigation and internal compliance controls. Various formulations could be developed on a trial basis, such as temporary waivers of sanctions enforcement, reduced penalties, and limited relief from regulatory actions for all but egregious willful violations. Moreover, if governments fund an NPO's projects, banks should be able to rely on such approval as adequate customer due diligence, since the extensive governance and reporting requirements that most government grantees must meet make additional customer due diligence by banks duplicative and unnecessary.

Create safe payment channels

When the international financial system is not able to meet the needs of NPO customers doing humanitarian work, new and special procedures to facilitate the transfer of funds into conflict areas may be needed. Thoughtful options to create safe banking and payment channels into high risk jurisdictions have been advanced, with most attention focused on ways to move international humanitarian funds into Syria. In the absence of a political resolution to the conflict, potential solutions are likely to include identification of private banks approved to receive humanitarian-related funds. While a range of options to develop a safe payment corridor are under discussion, all are complicated in terms ensuring compliance with sanctions and preventing diversion. Such efforts require concerted efforts by like-minded governments and regulators, banks and NPOs, and international organizations, and are likely the only option to provide humanitarian assistance to conflict areas where need is greatest but where banks will not go without such assurances.

For NPOs who have lost their bank accounts but are providing services supported by governments, a public entity, such as a central bank or regional development bank might facilitate the movement of funds into high risk areas on an emergency basis. It is important to recognize, however, that in some humanitarian crises, reliable documentation and ordinary due diligence required of NPOs are likely to be unrealistic, given unique local conditions. Alternative ways to avoid inadvertent support to designated groups could be explored but ultimately there is no "fail safe" solution in transferring funds into some environments. Developing shared views of which destinations and characteristics are acceptable and a shared responsibility are necessary to deal with crises.

Improve humanitarian licensing and exemptions

Sanctions have increased in number and scope, and include multilateral UN measures, regional EU sanctions, and unilateral measures by the US and other countries. These sanctions have had significant impacts on the ability of many NPO to operate, with licenses often requiring months to process. Suggestions to improve licensing of humanitarian relief efforts and the payments needed to carry them out should be explored.

While the Office of Foreign Assets Control (OFAC) utilizes general licenses (whereby no prior approval is necessary if certain conditions are met) to implement humanitarian exemptions from sanctions for countries such as Syria, other countries need to develop more flexible approaches to facilitate humanitarian assistance. The mutual recognition of licenses granted by other countries could also be explored.

To promote more flexible licensing, United Nations Security Council sanctions resolutions should routinely include humanitarian exemptions (UNSCR 2317 concerning Somalia is the only sanctions regime that has adopted a humanitarian exemption) or a standing humanitarian exemption should be adopted by the Security Council.

Explore Technological Solutions to Facilitate NPO Transfers

With new payments platforms, innovative technologies have emerged that could increase efficiency and reduce compliance burdens associated with banking NPOs. Technological options to enhance transparency and information sharing capabilities such as KYC utilities, e-credits, and legal entity identifiers could help promote NPOs transfers and lower the cost of CDD compliance in banking NPOs. The World Bank/ACAMS process is exploring the parameters for a repository/utility containing comprehensive information on NPOs.

Provide capacity assistance

The complexity of AML/CFT/sanctions policies has increased substantially, and many countries and their stakeholders lack resources to effectively implement regulatory requirements. Some countries assert that their inability to train regulators, banks and affected communities such as NPOs, in implementation may exacerbate de-risking. Capacity building assistance is needed in numerous countries to explain regulatory requirements and compliance obligations to stakeholders.

Concluding Thoughts

The scope, severity and effects of narrowing financial access for U.S. NPOs is alarming. The fact that 2/3 of NPOs face difficulties with international financial transactions, and that 37% experience delays of wire transfers is a cause for alarm, especially as the situation appears to be worsening. These problems affect many different types of organizations and programs in all parts of the world, indicating a systemic problem. The resulting harm whereby people needlessly suffer from starvation, disease, terrorism and conflict, is tragic and unacceptable.

The underlying AML/CFT/sanctions policies related to the de-risking phenomena are valid and critical security objectives, but the damaging unintended consequences of these policies threaten to undermine vital U.S. interests. A commitment of all stakeholders—U.S. policymakers and regulators, financial institutions and nonprofits—to the shared responsibility of finding solutions to the financial access problems of NPOs is necessary to address this growing crisis. Without acknowledging the deleterious humanitarian consequences of restricted financial access for NPOs, as well as concerted action to address it, the situation will continue unabated, undermining U.S. foreign and security policies. US leadership on this critical issue is necessary.

Biography

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The Honorable Sue E. Eckert is an Adjunct Senior Fellow at the Center for a New American Security, where she focuses on issues at the intersection of economics and national security. Research interests include economic statecraft, sanctions, terrorism and proliferation financing, and cybersecurity. She also is an adjunct professor of law at Case Western Reserve Law School, teaching in the first master's degree program in financial integrity.

She was appointed by President Clinton and confirmed by the U.S. Senate as Assistant Secretary of Commerce for Export Administration (1993-1997), responsible for dual-use export control policy and defense industrial base programs. Previously, she was a member of the professional staff of the U.S. House of Representative's Committee on Foreign Affairs, where she oversaw national security/nonproliferation, international trade, and technology transfer issues.

From 1998-2016, Ms. Eckert was Senior Fellow at Brown University's Watson Institute for International and Public Affairs where she directed projects on U.N. targeted sanctions, terrorist financing, and economic security. Recent publications include: *Financial Access for U.S. Nonprofits* (2017); *Targeted Sanctions: The Impacts and Effectiveness of UN Action* (2016, Cambridge University Press); *The Compendium of the High Level Review of UN Sanctions* (resulting from the 2014-15 initiative supported by five Member States and led by Ms. Eckert and colleagues to strengthen the implementation of U.N. sanctions); and the "The Role of Sanctions" in *The UN Security Council in the 21st Century.* She also collaborates with the U.S. Naval War College, hosting biannual cybersecurity workshops and forming a new political economy of security initiative of scholars.

She co-led an international research initiative (*Targeted Sanctions Consortium)* of more than 50 scholars and practitioners examining the impacts and effectiveness of United Nations targeted sanctions, resulting in the creation of two new databases and a new online tool, *SanctionsApp*. Working extensively with national governments and U.N. bodies to enhance instruments of collective security, Ms. Eckert co-authored *Targeted Financial Sanctions: A Manual for Design and Implementation* and the series of "Watson Reports" to address due process concerns in sanctions designations, participated in multilateral initiatives (the Interlaken, Bonn-Berlin, and Stockholm Processes), and organized workshops, simulations, and training for the Security Council and Member States, among others.

Ms. Eckert has served as a consultant and member of numerous working groups and committees addressing security and technology issues, including the National Academy of Sciences Committee on Deterring Cyberattacks, and the Resource Group advising the United Nations High-Level Panel on Threats, Challenges, and Change. She has testified before the U.S. Congress and Canadian Parliament, United Nations, and European committees, participated in numerous other international fora and is a frequent commentator on international security issues.

FINANCIAL ACCES

for U.S. NONPROFIT

By Sue E. Eckert

with Kay Guinane and Andrea Hall

Executive Summary & Data Highlights

FEBRUARY 2017

TO READ THE FULL REPORT PLEASE VISIT:
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ABOUT THE CHARITY AND SECURITY NETWORK

The Charity & Security Network is a resource center for nonprofit organizations to promote and protect their ability to carry out effective programs that promote peace and human rights, aid civilians in areas of disaster and armed conflict and build democratic governance.

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EXECUTIVE SUMMARY

In response to the September 11, 2001 attacks on the United States, the regime to deny terrorists and criminals access to the global financial system has significantly expanded. Financial institutions (FIs), the lynchpin of the system, are required to employ a "risk-based approach" to assess their money laundering and terrorist financing (ML/TF) vulnerabilities, know their customers, and implement compliance programs to manage and mitigate situations of higher risk.

Over time, a number of factors, including anti-money laundering (AML) and countering the financing of terrorism (CFT) regulatory obligations and oversight of FIs, have led to the phenomenon of "derisking." This refers to the trend of financial institutions terminating or restricting business relationships to avoid rather than manage risk. The most frequently mentioned driver of derisking, as cited by FIs, is the concern for running afoul of regulatory requirements.

There are costly consequences of derisking for a variety of sectors, including nonprofit organizations (NPOs). In particular, examples have come to light of lifesaving assistance stymied as a result of charities' inability to transfer funds to foreign countries, including humanitarian disasters in Syria, Somalia and other conflict areas. Banks under pressure to comply with AML/ CFT regulatory expectations and sanctions have delayed or denied financial transfers and closed accounts, complicating efforts by charities and humanitarian groups trying to deliver aid.

Until now, there have been no data indicating the scope and type of difficulties U.S. NPOs might be experiencing. This research initiative, commissioned by the Charity & Security Network and supported by the Bill and Melinda Gates Foundation, was undertaken to develop empirical data to inform the policy discussions concerning derisking and financial access.

With this report, *the question as to whether financial access is a problem for NPOs has now been answered: it definitively is.* Years of anecdotal evidence reported by NPOs regarding difficulties with financial services are now confirmed through a random sample survey of U.S. nonprofits, using Internal Revenue Service data on public charities that do international work (NPOs).

Survey Results Show There is a Systemic Problem

This report presents empirical data from the random sample survey undertaken for this study. The findings are valid within a 5.4% margin of error. The results paint a picture of significant problems, affecting many kinds of NPOs operating in all parts of the globe. Highlights of the survey findings are below:

Characteristics of U.S. NPOs Working Internationally

- There are 8,665 U.S. NPOs operating abroad (based on IRS data).
- They work in a range of sectors, including education, development/poverty reduction, humanitarian relief, public health, medical services, human rights/democracy building and peace operations/peace building, among others.
- 45% of all U.S. NPOs engage in humanitarian relief work.
- Most NPOs are relatively small (median revenues of $1.5 million and expenditures of $1 million), but almost half of them (48%) are large enough to operate a branch or field office abroad.

Financial Access Problems

- 2/3 of U.S.-based NPOs working internationally experience banking problems.
- The most common problems include: delays of wire transfers (37%), unusual documentation requests (26%), and increased fees (33%). Account closures represent 6% and refusal to open accounts 10%.
- 15% encounter these problems constantly or regularly.
- The prevalence and types of problems vary by program area, with NPOs working in peace operations/peacebuilding, public health, development/poverty reduction, human rights/democracy building, and humanitarian relief reporting the greatest difficulties.
- Transfers to all parts of the globe are impacted; the problem is not limited to conflict zones or fragile and failing states.
- NPOs with 500 or fewer staff are more likely to encounter delayed wire transfers, fee increases, and account closures. Most significantly, smaller organizations are almost twice as likely to receive unusual additional documentation requests. The smallest NPOs (those with 10 or fewer employees) are having the most trouble opening accounts.
- NPOs, categorically treated as high-risk, are sometimes forced to move money through less transparent, traceable, and safe channels as a result of delays in wire transfers and requests for additional documentation.

The scope of the problem, which affects 2/3 of U.S. NPOs and programs in all parts of the world, constitutes a serious and systemic challenge for the continued delivery of vital humanitarian and development assistance – a core component of American foreign and security policies. As a result, financial access for NPOs must be recognized as a barrier that needs to be addressed on par with correspondent (intermediary) banking and money service businesses (MSBs). It is time to move beyond discussions of whether there is a problem, arguments over definitions, and the finger-pointing that have characterized the issue to date. Now is the time to seek solutions.

As NPOs' ability to access the financial system has been hampered, the level of humanitarian need worldwide has reached all-time highs. Refugees fleeing war, climate disasters and political repression have generated the largest number of displaced people since World War II, making the programs U.S. NPOs operate in other countries more important in saving lives and preventing the further erosion of democracy and human rights.

The Drivers of Narrowing Financial Access for NPOs Are Complex

There is no simple or singular reason for derisking generally or of NPOs specifically, and this study does not contend that all decisions by FIs to terminate NPO accounts or delay wire transfers are attributable exclusively to AML/CFT concerns. However, interviews for this report, as well as regular surveying of the financial industry, consistently demonstrate that FIs' compliance-related concerns and regulatory expectations are among the most significant reasons for derisking. A multiplicity of factors has indeed created a "perfect storm" resulting in serious unintended consequences which limit financial access for NPOs.

For many FIs, decisions to withdraw or decline to provide financial services involve customers perceived to be higher-risk, such as NPOs, and higher-risk jurisdictions (often the countries where humanitarian assistance and development NPOs work). Routine second-guessing of FIs' decisions and treatment of certain clients as categorically high risk by bank examiners require FIs to undertake extensive and expensive steps to mitigate those risks, tipping the risk-reward scale toward exiting such relationships. Despite reassuring statements from government officials, FIs perceive a clear disconnect between what policy officials say and what happens at the individual bank examination level.

Action Is Needed

To effectively address the problems of derisking/financial access, all stakeholders must work together in a concerted effort. Solutions will only be found if the problem is approached as a shared responsibility. Policymakers' characterizations of these issues as solely "commercial decisions" ignores reality and is a recipe for continued derisking and all of its consequences.

There has been little recognition by U.S. officials that financial access is a problem for NPOs, in contrast to the public acknowledgement of derisking in the context of correspondent banking and MSBs. U.S. policymakers and regulators appear reluctant to take NPOs' concerns seriously or to address these issues. Skepticism, along with long-held attitudes that the NPO sector is high-risk, pervades many discussions, from the policy levels down to individual bank examiners. FIs are likewise reluctant to devote resources to address issues regulators do not treat as a priority.

The result is a clear lack of leadership and accountability on derisking issues, as noted in previous reports. Government points to the private sector, banks point at regulators, and NPOs are frustrated and left without financial services. A recent dialogue initiated by the World Bank and Association of Certified Anti-Money Laundering Specialists (ACAMS) shows promise in bringing stakeholders together.

All parties would benefit from solutions to these financial access issues, but the associated cost makes it unlikely that any individual group can or will undertake them alone. The ideal solution is therefore, collective action, the cost of which is shared. Leadership from policymakers and regulators is necessary, starting with acknowledgment of the seriousness of the issue, and moving to action to clarify regulatory expectations and articulate a coherent policy.

Inaction is Costly

Importantly, the human costs of NPOs' financial access difficulties and continued inaction must be recognized. When programs are delayed or cancelled because of the inability to transfer funds, peace is not brokered, children are not schooled, staff is not paid, hospitals lose power, the needs of refugees are not met and in the worst cases, people die. Maintaining current policies in the face of evidence of the negative humanitarian consequences is not only harmful but inconsistent with American values.

There are multiple interests at stake in the derisking crisis. In this context, broader foreign policy and security concerns appear to be underappreciated. The goals of financial inclusion and financial integrity have been characterized as incompatible, but both can be achieved. Ironically, current policy has created consequences that increase the risk of illicit finance. Because these problems are not being effectively managed, U.S. policy objectives of development, humanitarian assistance, and even countering terrorism and violent extremism are negatively impacted.

Protection of the global financial system from abuse by criminal and terrorist organizations has been and will continue to be an essential element of U.S. national security policy. A key component of multilateral counterterrorism/countering violent extremism (P/CVE) initiatives is the ability of civil society organizations to engage and support local populations where terrorism takes root. NPOs play a vital role in this effort.

The U.S. government process to address financial access issues, however, remains heavily weighted to illicit finance concerns, with the range of other agencies and interests not playing a commensurate role. Ultimately, even AML/CFT objectives are not promoted when financial access of NPOs is restricted. Excessive regulatory expectations and enforcement are pushing more money into opaque channels where it is more likely to fall into the wrong hands. Fear of compliance failures results in a vacuum that is likely to be filled by less transparent and accountable financial institutions, undermining the integrity of the global financial system and U.S. security.

Recommendations

There are several promising avenues for stakeholders to explore. The recommendations and options discussed in this report should be viewed as the starting point in a process that moves toward solutions and in no way do they exclude additional ideas that emerge from further consideration of the problem. However, in order to be effective, solutions must meet these basic criteria:

- Address the drivers of narrowing financial access for NPOs
- Adapt to all sizes of NPOs and FIs
- Improve the implementation of the risk-based approach to AML/CFT programs
- Avoid anything that would make compliance more complex and burdensome

This report recommends the following:

Launch a Solutions-Oriented Multi-Stakeholder Dialogue
There is an urgent need for all stakeholders to collaboratively review the existing illicit finance system and the policies designed to prevent it, and work to address the serious and systemic problems hindering financial access for U.S. nonprofits. For that reason, this report's top recommendation is for a multi-stakeholder dialogue to work towards solutions to NPO financial access problems.

Update the Bank Examination Manual and Bank Examiner Training
As enforcers of the Bank Secrecy Act with the ability to impose civil fines, Federal Bank Examiners are key to regulatory oversight and significantly influence FI behavior. As this report reveals, their work is often intrusive, second-guessing FIs' due diligence procedures and applying pressure that increases compliance costs and discourages FIs from serving their NPO customers. In addition, regulatory oversight often varies by examiner and the inconsistency adds to FI uncertainty. As suggested by multiple FIs interviewed for this report, a program is needed to re-train examiners to bring them up to date on the risk-based and proportionate framework, to create consistency between FI examinations, and to emphasize that NPOs are not by definition high-risk customers.

The NPO section of the Bank Examination Manual has not been updated to reflect the June 2016 changes in the Financial Action Task Force's Recommendation 8. A collaborative effort between FIs, NPOs and the Federal Financial Institution Examination Council is needed to remove outdated language concerning risk assessment of NPOs. The resulting revision should guide FIs through a proportionate risk-based approach.

Create an NPO Repository/Utility to Streamline FI Customer Due Diligence

Technology-based solutions that enable effective and proportionate FI compliance, often referred to as "utilities," can tackle much of the paperwork and oversight that results in rising compliance costs and hence, restricted financial access for NPOs. These utilities can eliminate much of the burdensome and duplicative documentation requests cited by numerous focus group participants. One proposal calls for a repository created specifically for NPO financial access purposes that would set out customized criteria that allow all types of organizations—large and small, established and new, secular and religious—to be included. FIs could then use the repository to collect information for their customer due diligence, obtaining it quickly and inexpensively. Using existing models as a guide, a team of lawyers and financial industry experts would evaluate the information submitted by NPOs.

Create a Special Banking Channel for Humanitarian Crises

As discussed in Chapter 7 of this report, the most profound and perhaps devastating impact of NPOs' financial access problems is the loss of humanitarian programming. When the international financial system is not able to meet the needs of NPO customers doing humanitarian work, new and special procedures to facilitate the transfer of funds overseas may be needed. Given the dire humanitarian need in places like Syria, it is even more important that fund transfers are timely and that NPOs have access to bank accounts. Although special procedures would not address the systemic problem revealed by this study, they could alleviate some of the most dangerous and serious impacts.

Institute Safe Harbor Protections

The World Bank/ACAMs dialogue suggested the creation of safe-harbor provisions, whereby FIs that bank NPOs in good faith and meet certain criteria would be held harmless if funds inadvertently ended up in the wrong hands. Adopting a safe harbor would give U.S. banks confidence that they can do business with higher-risk customers and regions provided they maintain rigorous risk-mitigation controls that are recognized by regulators. Investment in consistent and effective due diligence procedures would lessen the threat of prosecution or regulatory enforcement, or at a minimum, cap penalties at nominal amounts. This approach could be highly effective in expanding financial access for NPOs.

Improve Implementation of the Risk-based Approach

FATF has updated its risk-based approach to make it proportionate and ensure that it does not negatively impact the work of legitimate NPOs. This framework is focused on effectiveness, and is relatively new. In particular, the notion of residual risk acceptance, inherent in the risk-based approach, is not always reflected in current rules or enforcement policies. As the FATF noted in its 2016 mutual evaluation of the U.S., terrorist financing and sanctions violations "are strict liability offenses." There is an inherent tension between strict liability and a risk-based approach that appears to contribute to narrowing financial access for NPOs. Steps to improve implementation of the risk-based approach include:

- Counter the outdated portrayal of NPOs as “particularly vulnerable” to terrorist abuse by incorporating the FATF’s revised Recommendation 8’s risk-based, proportionate approach into relevant rules and guidance, such as the Bank Examination Manual.
- Develop clear guidance and standards to reduce guesswork and compliance costs so that they outline what information is required to ensure legal compliance by both banks and NPOs.
- Promote transparency, information sharing and proportionality to recalibrate risk perception so that fear of harsh penalties for inadvertent violations does not drive FI risk assessment. Give credit for measures taken in good faith.
- Create incentives to encourage appropriate risk management so that FIs will not avoid NPOs as customers.

Explore Alternatives to the Formal Banking System

In cases where formal financial transfers remain problematic, U.S. and international organizations could identify appropriate informal payment channels that NPOs can utilize to help lessen reliance on carrying cash. Alternative methods of moving funds, such as Bitcoin and other virtual currencies, mobile money, and new electronic payment systems, should be explored.

Impractical Options

The findings in this report are likely to generate other ideas for increasing financial access for nonprofits that merit further consideration. At the same time, however, some ideas have been proposed which, upon examination, were found to be unworkable for a variety of reasons. Others have been attempted without success. This report suggests that government sponsored “white lists” of approved NPOs, appeals to FI social responsibility programs, or NPO-focused efforts to build relationships with local bank managers are either unlikely to effectively address the NPOs’ financial access difficulties or have the potential to create additional problems.

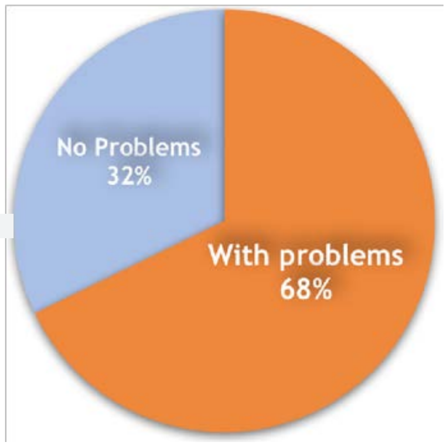
DATA HIGHLIGHTS

Following are select figures and tables from the complete report, highlighting the most important data findings.

To read the full report, go to www.charityandsecurity.org/FinAccessReport

Scope of NPO Financial Access Problems

A significant proportion (2/3) of NPOs that conduct international work are experiencing obstacles in accessing financial services.



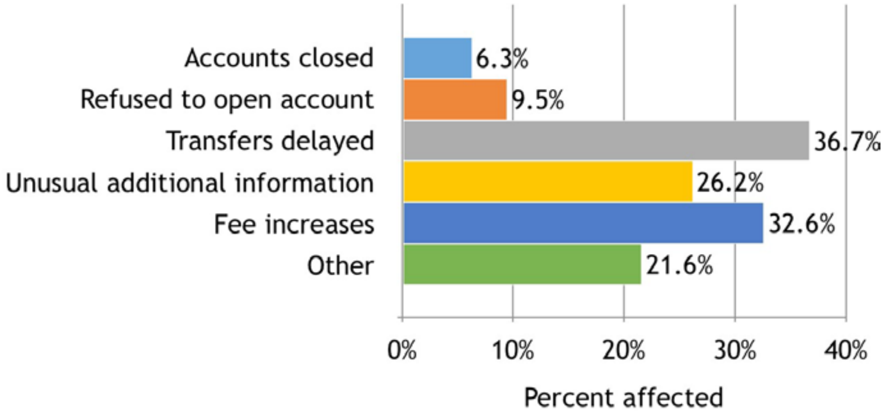
Frequency of Financial Access Problems

Frequency of financial access problems	Total organizations (percent)	Total organizations likely impacted
Constant	5.4	468
Regular	9.7	841
Occasional	31.2	2,703
Rare	21.5	1,863
Never	32.2	2,790
TOTAL	100.0	8,665

Over 15% of NPOs encounter these financial problems constantly or regularly, with another 31% reporting occasional problems.

The two most common problems encountered by NPOs are delayed wire transfers and increased fees. Although account closures are less common than transfer delays, they can have an extraordinary impact.

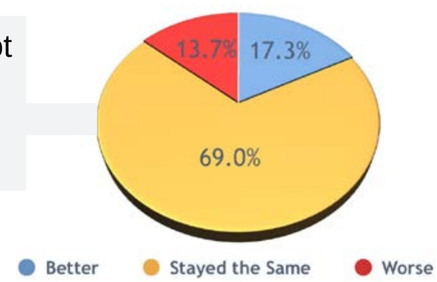
Prevalence of Financial Access Problems*



*Percentages do not total 100% because survey respondents were allowed to give more than one response.

Perception of Change in Severity

Overall, financial access problems for NPOs are not improving. 69% of NPOs surveyed report that the problem has stayed the same, while approximately 13.7% say it is getting worse.



NPOs utilize a variety of strategies to cope with financial access problems, some of which put the safety of their staff and the integrity of the financial system at risk. Of significant concern is the data indicating that 42% of NPOs resort to carrying or sending cash when traditional banking channels become unavailable.

Strategies Used to Address Problems*

Strategies	Percent of NPOs Utilizing
Carry cash	41.7
Cancel the program	3.4
Find another financial institution	36.5
Use money remitter (Western Union or similar)	29.4
Performed a transaction successfully later	67.2
Other	24.9

*Percentages do not total 100% because survey respondents were allowed to give more than one response.

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