INSPIRING FINANCIAL LEADERSHIP

Briefing: Impact of banks' de-risking on Not for Profit Organisations

March 2015

Charity Finance Group's (CFG) vision is to inspire the development of a financially confident, dynamic and trustworthy charity sector. CFG works with finance managers to enable them to give the essential leadership on finance strategy and management that their charities need; promote best practice in charity finance, drive up standards, and campaign for a better operating environment as well as ensure every pound given to charity works harder. CFG has more than 2,300 members, and collectively our members are responsible for the management of over £20bn in charitable funds.

The aim of this briefing is to cover some of the issues that charities are facing due to de-risking activities by bank in the wake of the financial crisis and a tougher regulatory environment and the impact that this has had on charities as well as ways to improve the banking environment for charities.

Background

Anti-money laundering and counter terrorism regimes place burdens on banks and financial institutions to ensure that global economic crime is effectively interrupted. A zero tolerance of known money laundering, fraud and terrorist financing should not, however, be translated into a zero appetite for risk. This is particularly true where charities are working to help some of the most vulnerable people in the world in challenging environments.

Effective risk management is always about striking an appropriate balance between reducing exposure to risk and still being able to continue the legitimate activities. Risk cannot be eradicated it can only be managed. One way through which banks and financial institutions can manage risk is avoidance of it. Avoidance of activities or certain customers ('de-risking') can be desirable because the steps required to mitigate risk to an acceptable level outweigh the benefits which flow from managing it

This method has had a particularly significant impact on the global third sector, which by its very nature works in risky environments. We need a global financial system which is able to effectively manage risk, whilst enabling charities to carry out activities in challenging places. In this briefing we provide examples where charities have had difficulties in securing the necessary financial facilities to do their work.

CFG's work with DFID, BBA and others has found that due to the de-risking activities by banks, in response to the anti-money laundering and counter terrorism regimes, and as a result of 'hyper-vigilance' in some jurisdictions, charities are finding it increasingly difficult to send vital funds to conflict and 'at risk' locations.

In addition to anecdotal evidence previously provided to CFG we undertook a short survey of members in the July 2014, details of which are contained at the end of this briefing.

The survey was disseminated to CFG's membership, targeted specifically towards their Overseas Special Interest Group and Treasury Special Interest Group; it was also distributed via a BOND conflict forum. A small number of charities responded (26) resulting in the survey findings being indicative only. However their responses supported previously received anecdotal evidence. Respondent charities ranged from incomes of between £25,000 and over £50m.

This report explores the following:

1. Countries where charities have problems accessing banking services.
2. Problems charities are encountering with regards to accessing banking services.
3. Best practice and problem solving
4. Trends in banks' de-risking activities
5. The negative impact of banks' de-risking activities
6. Conclusions and policy recommendations

1. Countries where charities have problems accessing banking services

A number of countries have been referenced by charities as being problematic when accessing financial services. The problem locations include:

Iran, Kenya, Jordan, Iraq, Georgia, India, Sudan, South Sudan, Zimbabwe, Somalia, Syria, Afghanistan, Pakistan, and Sudan, Myanmar, Philippines, Lebanon, South Korea, USA, UAE, Sudan, Nigeria, Azerbaijan, Lebanon, Ukraine and North Korea.

Countries causing difficulty share at least one of the following characteristics:

1. Area where there is no formal banking infrastructure (e.g. Somalia)
2. Country where regulation is hyper-vigilant (e.g. USA)[1]
3. Country on a sanctions list (e.g. Iran, North Korea)
4. Country in a state of conflict (e.g. Syria, Ukraine)
5. Country where proscribed or terrorist groups are known to operate (e.g. Afghanistan)
6. Country in close proximity to, and typically serving as an access corridor to a region of instability (e.g. Jordan, providing access to Syria).

Proportionate and disproportionate de-risking

To assess the impact of banks' de-risking activities on charities it is important to differentiate between 'proportionate' and 'disproportionate' de-risking.

Proportionate de-risking activities might involve enhanced checks for charities sending money to a high risk region, and fair warning for checks being undertaken, so that they do not adversely impact on the efficiency of a charity's transactions.

Disproportionate might mean the refusal of transactions to high risk regions with no explanation and no dialogue regarding what measures could be taken in order to allow a transaction to go ahead or depriving charities of financial facilities without warning.

[1] Much of the regulatory pressure for banks' comes from the United States. This is due to a number of factors including: the presence of FATF in the US, the political momentum for the financial war on terror, the dominance of US banks' in the global banking market (and therefore connectivity of transactions for clearing purposes) and the global role of the dollar as the most used and traded currency.

In general, our investigations have found that banks are more frequently proportionate than disproportionate in their de-risking activities. However incidents of disproportionate de-risking are a significant feature of reported problems and pose a long term challenge to the sector working in challenging environments.

NGOs recognise that there is a need for proportionate 'de-risking' activities. In the course of our work, we found that NGOs recognise the need for additional checks where new payments are being set up or where there is a lack of a formal banking infrastructure (e.g. Somalia) and thus funds will always be difficult to transfer safely and securely.

2. Problems charities are encountering with regards to accessing banking services

A number of problems were reported by charities in the course of our work. The most common problems included:

- International transfers delayed by bank
- Requests for further information before proceeding with the transaction and international transfers delayed by a correspondent bank
- International transfers denied by a correspondent bank
- Problems getting funds transferred to a partner or own bank account in a high risk country
- International transfers denied by bank
- Funds frozen due to a banks' due diligence process
- Delays in opening bank accounts
- Accounts closed
- Donations blocked

Survey respondents' experiences

"In the registration at the charity commission we had mentioned that we do work in Syria, so all our requests to open a bank account in the UK were rejected except one bank... we are facing so many issues with this bank in all aspects from the very high service fees, to the lack of support and so many other issues, but we have no alternative solutions"

"A donation to fund activities in Jordan, Iraq and Lebanon, supporting refugees from Syria, referred to Syria. The transfer was sent and returned to the donor by our bank (or the intermediary) as it referred to Syria."

Amongst respondents, problems with correspondent banks occurred more commonly. Correspondent banks are used by banks to service transactions originating in foreign countries and act as a bank's agent abroad. This is often due to a bank having limited access to a particular market.

Steps to limit the impact of de-risking activities on UK NGOs must also take into account the activities of correspondent banks. Even if UK banks are not acting disproportionately, their correspondent partners in different countries may do so. It is vital that the UK regulatory regime is not viewed in isolation. The global context of banking and anti-money laundering regimes have a huge impact and need to be considered when assessing solutions to problems faced by UK charities.

Our work has found inconsistencies in the way banks treat charities overseas payments as between banks and within the same banks. This inconsistency creates uncertainty which might originate from a lack of shared understanding or an absence of guidance on how to respond to relevant legislation and regulation.

3. Best practice and problem solving

Our survey asked a number of questions about what charities are doing to develop strong relationships with their banks to avoid problems arising from the bank's de-risking activities as well as steps taken to reassure banks of the reliability of their own due diligence processes and financial controls.

We did not find common themes established regarding the measures charities undertake to reassure banks of the legitimacy of their transactions. The diversity of the sector and its activities means that banks must avoid a 'one size fits all' approach to working with NGOs.

However, charities have taken a number of measures to help banks including:

- Explaining the purpose of each transaction
- Providing contact details for a person familiar with the transaction
- Taking responsibility for determining the legality of the payment; eg provide details of end receiver of the transaction, including any affiliations with any sanctioned party
- Providing the details of any specific or general license which permits the transaction
- Engaging with regulators to ensure actions are, if necessary, covered by general or specific licenses and make reference to any licenses in payment instructions

We believe that these relatively simple mechanisms may provide charities, if used proactively, with a way of reducing delays and providing banks with assurance of the legitimacy of transactions.

However, we found that most charities did not proactively take steps with the banks in known high risk areas. The majority of charities provided extra information only when sought by the bank. Noticeably, those that said that they had developed specific measures were typically larger organisations by income. This demonstrates the need for more support to be given to small and medium sized charities that work in challenging environments.

Where organisations had developed specific or operated general measures with their banks to counteract the threat from money laundering or terrorist financing, some interesting examples, which could be developed as best practice, were reported. These included:

- Meeting regularly with the bank relationship manager, where new countries with potential issues are highlighted; one charity said 'this creates an efficient mechanism to deal with problems there and then rather than when there is a problem with a transaction'.
- Having a good awareness of which banks have good operational links in which countries and selecting the banks for certain transactions in certain regions accordingly.
- Providing high-level details of the programming that is undertaken for every grant to the bank.
- Considering counter terrorism and de-risking delays in the program design stage. One charity said "*it is always in our program designing process, and before we decide the activities a very important factor is what can't we do because of the sanctions*"

Finding ways to deliver humanitarian aid despite de-risking measures

Charities are finding ways of transferring funds despite de-risking measures. The use of money transfer services is reported by charities as one such mechanism.

One charity reported; *"Money transfers are used …while we try to open bank accounts or for short term projects. The majority of the time we use Western Union for new programmes. On occasions where this is not possible we either use cash couriers or specific transfer agents for that particular location".*

However governance challenges do exist for charities in taking such steps. For example a contributor told us that using money service businesses to, in their case, transfer money to Somaliland caused "…*great concern to our Trustees. But our programme would not be viable using the conventional banking system."*

Charities need to take into account these governance risks and develop appropriate processes for deciding when to take such actions.

Other ways that charities have sought to combat the loss of financial facilities due to de-risking activities were:

- Sending cash;
- Sending cash with staff;
- Using MoneyGram payments;
- Using FX providers;
- Using cash couriers;
- Using international brokers;
- Convoluted methods such as: 'paying to an account in the name of an expat in country and withdraw funds';
- Using PayPal; and
- Using MSBs.

Some of these activities are extremely high risk, such as sending cash with staff, and may actually increase the risk of money falling into the hands of terrorists or could put charity staff in significant danger. This makes it more important that issues around financial access for charities are resolved.

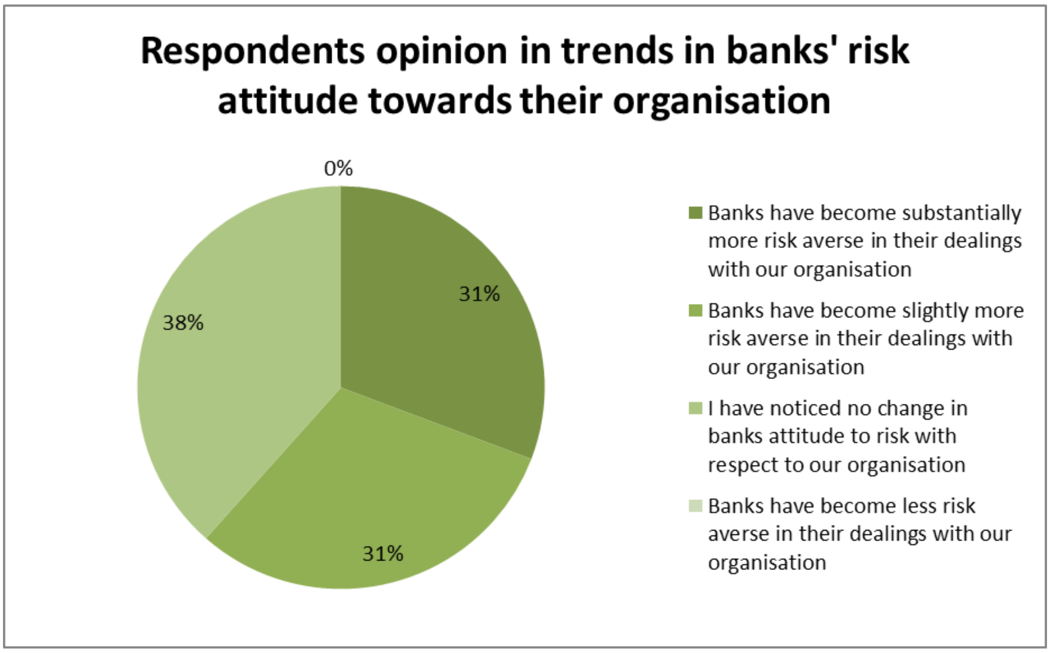
Charities will always seek to find ways to help those in need. The impact of bank's de-risking activities cannot be ignored. It is therefore imperative that regulators, banks and charities work together to develop systems whereby legitimate charitable activities are able to continue, taking place in the most dangerous and vulnerable locations in the world – where charities are often most needed.

4. Trends in bank's de-risking activities

Our survey asked a number of questions on the types of de-risking activities that had impacted them.

Firstly, respondents were asked to comment on trends they had noticed in banks' attitudes to risk in recent years.

Figure 1: Trends in banks' risk aversion



The majority of charities reported either some or significant increases in the risk averse attitude of their banks in recent years. No charities reported a decrease in risk aversion. When asked about the time period over which they had noticed their banks becoming more risk averse, respondents reported a period ranging from between the last 3 months to over the last 4 years.

The reasons given by banks to charities on their attitude towards risk typically gave reference to:

- sanctions,
- extensive security checks
- the UK Treasury Department and USA Government
- the hyper vigilance of US compliance staff
- increasingly onerous UK compliance standards
- Know Your Customer (KYC) concerns
- Anti-money laundering (AML)
- withdrawal from certain high risk areas

The range of factors highlighted indicates that this is a problem which requires a holistic solution combining a range of domestic and international actors.

5. The negative impact of banks' de-risking activities

Negative reported impacts of these de-risking activities should not be dismissed as merely inconvenient.

Charities have reported that large amounts of staff time are spent chasing balances and in some cases the administrative and cost implications of having to change banks, sometimes incurring higher transaction costs. But the larger concerns for charities impacted negatively by de-risking behaviour is the impact of delivering their humanitarian activities.

Charities have experienced delays getting humanitarian aid into countries, have closed down key partnerships; because they simply cannot continue to operate and, in some cases, stopping or shrinking programs in certain areas.

This creates a long term problem for governments around the world. Effective and timely delivered aid and support can help to prevent future geopolitical instability. However without the appropriate financial facilities being available, charities may be unable to carry out their work where it is most needed.

Alternatively, as highlighted above, charities may be forced to find more high risk methods to transfer funds which could benefit proscribed organisations and regimes.

6. Conclusion and recommendations

Charities recognise that the issue of banks de-risking is a global challenge and solutions cannot be implemented overnight. However, governments, regulators and banks cannot ignore the negative impact that de-risking activities of banks have had on charities trying to carry out their work in high risk regions.

Although banks in general are making efforts to be proportionate in their responses to de-risking, we know that there are cases where charities are suffering from disproportionate measures. Measures also need to be taken across the financial system including through correspondent banks.

Building on our work over the past few years on this issue, we have developed a number of recommendations for banks, charities and governments.

Recommendations for banks

- Put resources to understanding the activities of your charity clients and ask for further information when in doubt.
- Give fair warning (subject to any tipping off restrictions) to your clients where enhanced checks are required to avoid delays and help charities to plan.
- Work with charities to secure compliant and safe transfers of funds cross border.
- Challenge inconsistency within your bank and particularly with correspondent banks overseas.

Recommendations for charities

- Investigate which banks have good operational links in various countries or for certain transactions and be thorough before selecting the right bank for your work
- Build a good relationship with your bank through meeting regularly and building a mechanism for dealing with problems
- Provide details of your programmes to your bank and be clear on the purpose of transactions involved in carrying out your work
- Take responsibility for determining the legality of the payment; for example by providing details of the end receiver of the transaction, including any affiliations with any sanctioned party
- Provide the details of any specific or general license which permits the transaction
- Engage with regulators to ensure actions are covered by general or specific licenses and make reference to any licenses in payment instructions
- Consider and build in time provisions within your programmes for possible delays due to banking.

- Membership bodies should provide the means for charities to share information and best practice on financial matters.

Recommendations for governments and regulators

- Facilitate the work of banks and charities to ensure safe passage of funds to high risk areas; it's in everyone's interests that legitimate charitable activities are not impeded through disproportionate de-risking.
- Given the global nature of the counter-terrorism legal and regulatory landscape, it is important that governments and regulators begin a sustained international conversation about counter-terrorism legislation and how consistent principles can be applied so that legitimate charitable and humanitarian activates are not prevented.

Appendix A

Please see below for details of the demographic of survey respondents. Please contact CFG (policy@cfg.org.uk) for more information.

Figure 1 – What is the gross income of your charity

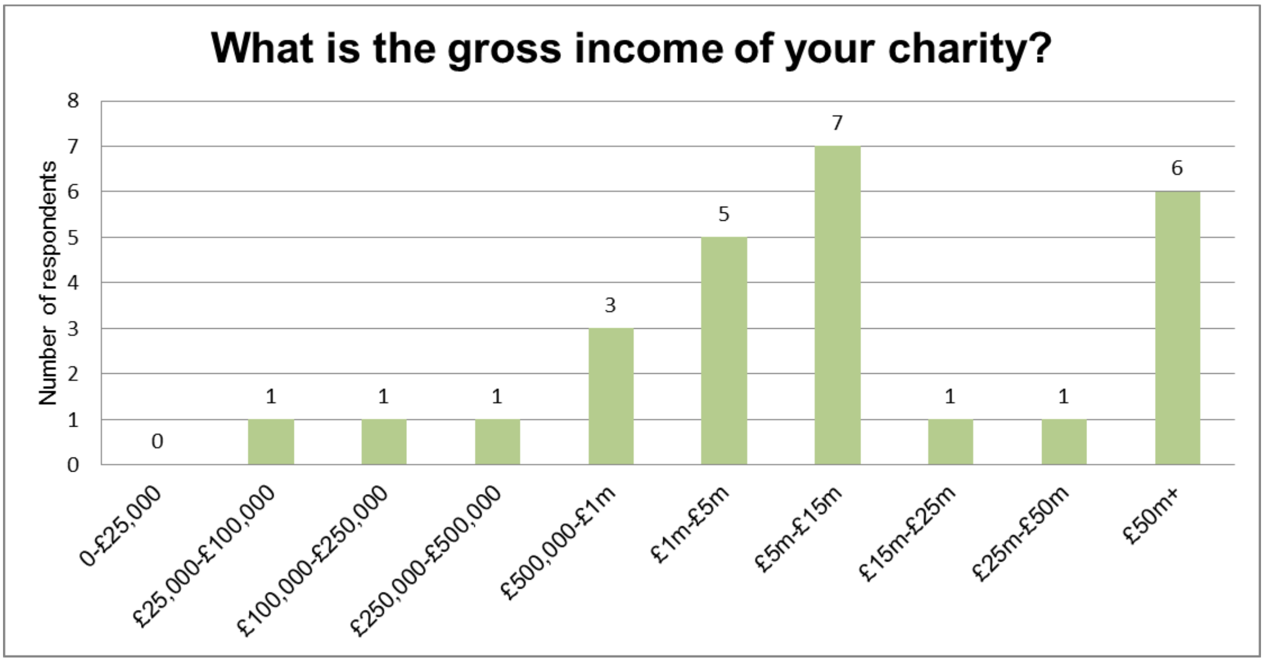


Figure 2 – Type of overseas aid that respondents provide

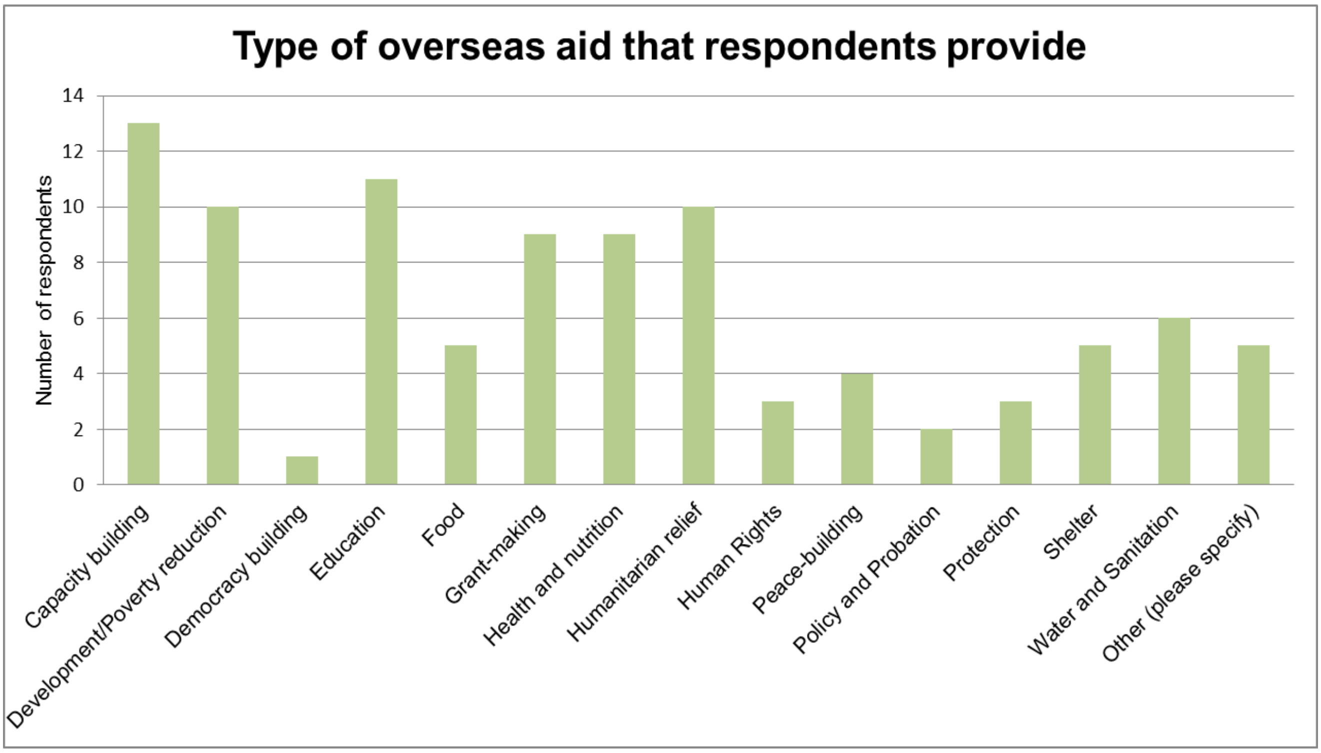


Figure 3 – Proportion of activities in 'high risk' areas

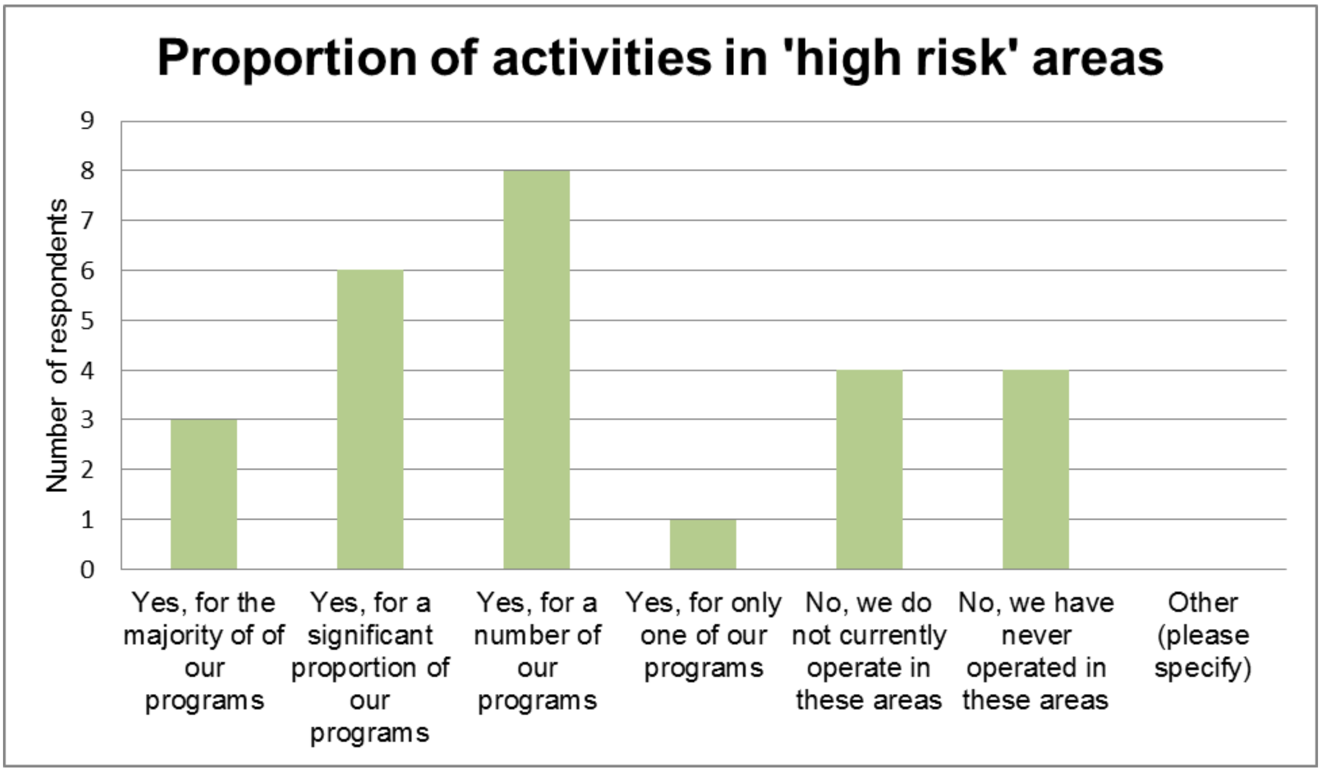


Figure 4 – Area of program operation