FINANCIAL ACCESS for U.S. NONPROFITS

By Sue E. Eckert

with Kay Guinane and Andrea Hall

Executive Summary & Data Highlights

FEBRUARY 2017

TO READ THE FULL REPORT PLEASE VISIT:
www.charityandsecurity.org/FinAccessReport

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.

1634 I Street NW Suite 1000
Washington, DC 20006
202.481.6927
www.charityandsecurity.org

ABOUT THE AUTHORS

Sue E. Eckert is Adjunct Senior Fellow at the Center for New American Security and Adjunct Professor of Law at Case Western Reserve Law School in the financial integrity program.

Kay Guinane is the Director of the Charity & Security Network.

Andrea Hall is the Communications and Outreach Coordinator for the Charity & Security Network.

ACKNOWLEDGEMENTS

This report was made possible by a generous grant from the Bill and Melinda Gates Foundation.

LICENSE

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.

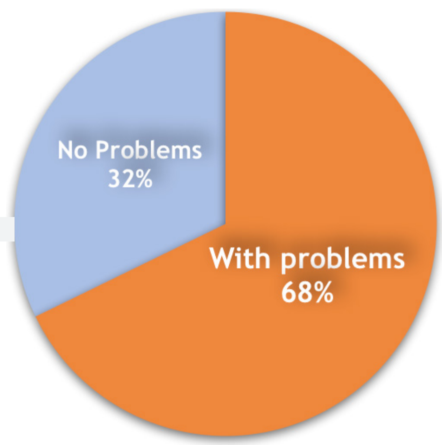
DATA HIGHLIGHTS

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.



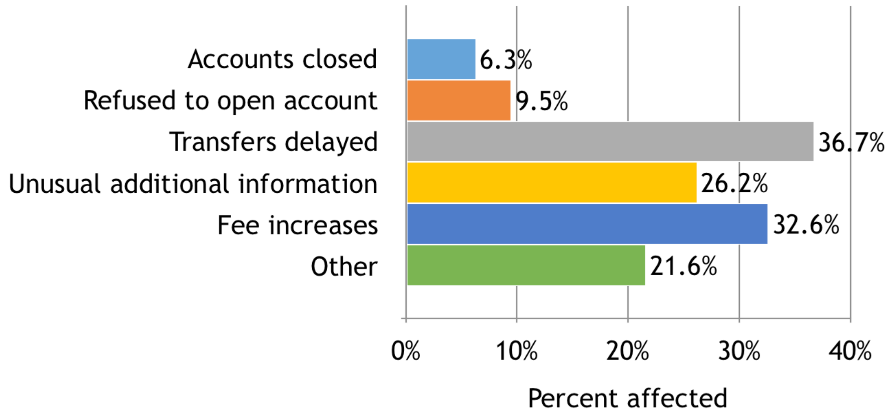
Frequency of Financial Access Problems

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.

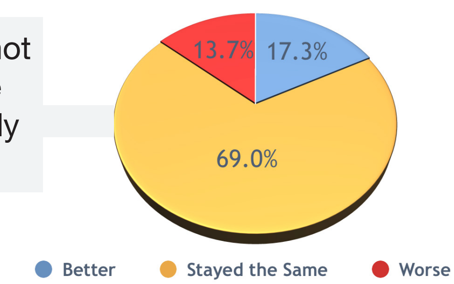
Prevalence of Financial Access Problems*



*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.

CHARITY & SECURITY NETWORK