INTRODUCTION

On September 8, 2000, the United Nations (UN) General Assembly adopted the Millennium Declaration, heralding the critical role of non-governmental organizations (NGOs) and civil society and broadening the definition of security beyond protection from external invasion to the quality of life, political freedom, education and human rights.[1] But one year later, the situation changed dramatically—a "zeitgeist," as some called it.[2] Following the 9/11 terrorist attacks, civil society organizations generally, and nonprofits in particular, were swept up in a new focus on counterterrorism. Harnessing new authorities and programs, CFT moved center-stage in the Bush Administration's "Global War on Terrorism."

Utilizing the U.S.'s influence in the global financial system, the Administration took an aggressive stance to stem the flow of money, calling it the "life-blood of terrorism—to terrorist groups."[3] Charitable organizations were considered vulnerable to terrorist abuse, and several were investigated, had their assets frozen and were shut down. In the years since, both experience and better data have led to a more-targeted approach. FIs and NPOs are expected to employ a "risk-based approach" (RBA) to their compliance programs, whereby they assess their ML/TF vulnerabilities and implement risk management and mitigation procedures in situations of higher risk.

Over time, a number of factors, including AML and CFT regulatory obligations on 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.[4] The most frequently mentioned driver of derisking cited by FIs is the concern for running afoul of regulatory requirements and expectations.[5] Established through the FATF recommendations, and implemented by national measures, AML/CFT requirements compel FIs to track money flows and "know their customers"

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1 United Nations General Assembly, United Nations Millennium Declaration, para. 30, UN Doc. A/55/L.2, September 8, 2000, http://www.un.org/millennium/declaration/ares552e.htm.

2 Douglas Rutzen, "Aid Barriers and the Rise of Philanthropic Protectionism," International Journal of Not-for-Profit Law, (vol. 17, no. 1), March 2015, http://www.icnl.org/research/journal/vol17ss1/Rutzen.pdf.

3 "President Freezes Terrorists' Assets: Remarks by the President, Secretary of the Treasury O'Neill and Secretary of State Powell on Executive Order," September 24, 2001, https://georgewbush-whitehouse.archives.gov/news/releases/2001/09/20010924-4.html.

4 There are varying distinctions in the definition of derisking. As defined by the FATF, derisking is the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF's risk-based approach. The U.S. government defines derisking as "instances in which a financial institution seeks to avoid perceived regulatory risk by indiscriminately terminating, restricting, or denying services to broad classes of clients, without case-by-case analysis or consideration of mitigation options." Remarks by Acting Under Secretary Adam Szubin at the ABA/ABA Money Laundering Enforcement Conference, November 16, 2015, https://www.treasury.gov/press-center/press-releases/Pages/jl0275.aspx.

5 "Banks have raised concerns about (1) the cost of complying with AML/CFT regulations, (2) uncertainty about supervisors' expectations regarding what is appropriate due diligence, and (3) the nature of the enforcement and/or supervisory response if they get it wrong." Remarks by Under Secretary Nathan Sheets at the Center for Global Development, November 12, 2015, https://www.treasury.gov/press-center/press-releases/Pages/jl0264.aspx.

so as to provide information useful to law enforcement in detecting and prosecuting illicit finance. There is widespread recognition of the importance of AML/CFT efforts as an essential component of U.S. security, and broad support for effective measures to prevent the use of the financial system for criminal purposes. Until recently, however, the unintended consequences of these policies, including derisking, have not been well appreciated.

Recognition of the phenomenon of derisking has grown significantly in the past few years and has been featured prominently in speeches at the 2016 UN General Assembly, reports by development agencies such as the World Bank, guidance and work plans of international financial and security bodies such as the Group of Twenty (G-20), Financial Stability Board (FSB), and FATF, statements by members of Congress concerned about local populations, and policy pronouncements by the U.S. government (USG).[6] Although disagreement persists about the appropriateness and even the definition of the term, derisking is now a well-documented occurrence.

Most often, derisking is discussed in terms of a decrease in correspondent banking (CB) relationships and the debanking of Money Service Businesses (MSBs),[7] leaving financial institutions, businesses, nonprofit organizations and individuals without access to essential financial services. Recent studies by the World Bank and other organizations confirm a significant decline in correspondent banking and an increased trend of account closures for MSBs.[8] The consequences of these trends are critical to many countries, indeed for entire regions of the world dependent on correspondent banks and remittance services for their economic survival.

In 2015, the USG and the FATF began recognizing and addressing some of these concerns. Largely absent from the policy discussions to date, however, is the impact of the derisking trend on NPOs, especially humanitarian and development groups working in conflict areas around the globe. Reports in November 2015 by the Center for Global Development (CGD)[9] and by Oxfam and the Global Center on Cooperative Security[10] highlighted the unintentional but costly consequences of derisking for a variety of sectors, including NPOs. In particular, examples have come to light of critical humanitarian assistance stymied as a result of charities' inability to transfer funds to foreign countries such as Syria, Somalia and other conflict areas, as well as support for millions of refugees in Europe. Banks under pressure to comply with AML/CFT requirements and sanctions

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6 See Bibliography in Appendix A for recent reports and statements on derisking.

7 Money Service Businesses are non-bank institutions providing check cashing, money orders, travelers' checks, money transfers and foreign currency exchange services. Money transfer operators (MTOs) are a subset of MSBs providing international remittance transfers. See Box on MSBs in Chapter 3.

8 Nearly half of financial institutions surveyed and 75% of large international banks indicated a decline in correspondent banking relationships. See Withdrawal from Correspondent Banking: Where, Why, and What to Do About It, The World Bank, November 2015, http://documents.worldbank.org/curated/en/113021467990964789/pdf/101098-revised-PUBLIC-CBR-Report-November-2015.pdf; Report on the G-20 Survey on De-risking Activities in the Remittance Market, The World Bank, October 2015, http://documents.worldbank.org/curated/en/679881467993185572/pdf/101071-WP-PUBLIC-GPFI-DWG-Remittances-De-risking-Report-2015-Final-2.pdf.

9 Unintended Consequences of Anti-Money Laundering Policies for Poor Countries, Center for Global Development ("CGD Study"), November 9, 2015, http://www.cgdev.org/publication/unintended-consequences-anti-money-laundering-policies-poor-countries.

10 Tracey Durner and Liat Shetret, Understanding Bank De-risking and Its Effects on Financial Inclusion, Oxfam and Global Center on Cooperative Security ("Oxfam/GCCS Study"), November 2015, http://www.globalcenter.org/publications/understanding-bank-de-risking-and-its-effects-on-financial-inclusion-2/.

have delayed or denied financial transfers, complicating efforts by charities and humanitarian groups trying to deliver aid. A recent report prepared for the UN, *Study on Humanitarian Impact of Syria-Related Unilateral Restrictive Measures*,[11] documented the "chilling effect" of the private sector's reluctance to support humanitarian activity. This reluctance, particularly on the part of banks, was fueled in part by a fear of fines stemming from inadvertent regulatory violations.

These complications occur at a time when the need for life-saving relief efforts in regions of conflict, protracted humanitarian crises and emergencies, compounded by severe access challenges, is greater than ever before. In 2015, international humanitarian assistance rose to an historic high of $28 billion, with many countries surpassing their own records for giving.[12] But despite this overall rise in international assistance, funding was not sufficient to meet growing needs; the UN reported an unprecedented shortfall of 45% ($9 billion) in unmet needs.[13] As of 2017, emergencies in Syria, Yemen, South Sudan, Iraq and Sudan, as well as long-term crises in Somalia and Pakistan, are still not being adequately addressed. Indeed, the very countries in most dire need of significant support are among those in which NPOs are having difficulties transferring funds.

To date, there have been no data available concerning NPOs and their problems accessing banking services, save for an informal indicative survey in 2014 of UK charities.[14] The CGD report recommended a number of steps to develop data, including a representative survey to provide an unbiased determination of the extent and nature of derisking of NPOs. At the same time, senior U.S. Treasury Department officials have called for more data "to continue to improve our understanding of the scope, nature, and drivers of the [derisking] problem through better data collection."[15] Meetings with Administration officials and Congressional staff alike all echoed the need for sound analytical data going beyond anecdotal examples.

Largely in response to the dearth of data concerning NPOs and the problems they face in obtaining financial services, the Charity & Security Network (C&SN), with funding from the Bill and Melinda Gates Foundation, commissioned this report in late 2015. C&SN is a resource center for NPOs to collectively promote human security and protect their ability to fulfill their missions.

The purpose of this initiative has to been to understand financial access issues encountered by the nonprofit sector as charities attempt to carry out their important work abroad. Moving beyond anecdotes, the study set out to gather empirical data as to the scope and nature of NPOs'

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11 Justine Walker, Study on Humanitarian Impact of Syria-Related Unilateral Restrictive Measures: National Agenda for the Future of Syria, May 16, 2016, https://assets.documentcloud.org/documents/3115191/Hum-Impact-of-Syria-Related-Res-Eco-Measures-26.pdf.

12 Development Initiatives, Global Humanitarian Assistance Report of 2016, http://www.globalhumanitarianassistance.org/wp-content/uploads/2016/07/GHA-report-2016-full-report.pdf.

13 Ibid.

14 "Charity Finance Group, Briefing: Impact of banks' de-risking on Not for Profit Organisations," March 2015, http://www.cfg.org.uk/Policy/~/media/Files/Policy/Banking/Briefing%20%20Impact%20of%20banks%20derisking%20activities%20on%20charities%20%20March%202015.pdf.

15 Remarks by Under Secretary Nathan Sheets at The Center for Global Development. November 12, 2015, https://www.treasury.gov/press-center/press-releases/Pages/jl0264.aspx, and Szubin Remarks, November 16, 2015.

difficulties accessing financial services. Questions explored the prevalence of financial access problems, specific obstacles charities encounter in transferring funds, the geographic destinations most problematic (e.g., limited to higher-risk countries with ongoing conflict or globally) and strategies NPOs employ when formal banking channels are not available to support programs. The study focused specifically on U.S.-based nonprofits working internationally even though problems have been noted in the U.K., Australia and elsewhere. As such, the report is a starting point in understanding barriers nonprofits face; going forward, additional data should be gathered on comparable problems in other countries to expand knowledge of the scope of the challenges. At this time of transition in the Executive Branch and Congress, the report provides important new data to inform the policy discussions going forward.

Organization of the Report

This report is organized into four sections.

Section One summarizes the methodology used in the research for this report, which includes extensive interviews, focus group discussions and a random sample survey of U.S. nonprofit organizations. It also includes background chapters to establish the context within which both FIs and NPOs operate and describe the derisking phenomenon.

Section Two provides a summary of the data and analysis from the quantitative portion of the study, a random sample survey of American nonprofits.

Section Three contains the results of discussions with U.S. policy and regulatory officials, financial institutions, and NPOs. It was through these sessions that examples of NPOs' financial access difficulties, including the impact on the delivery of humanitarian aid, were discussed.

Incorporating both the qualitative and quantitative data, **Section Four** contains observations on the information gathered, summarizing what we now know concerning financial access for NPOs. The concluding chapter proposes a range of options and recommendations to address these problems and create a more sustainable collaborative process among stakeholders going forward. It also lays out an agenda for future research and policy discussions more broadly.

Special Notes

The following notations are provided to clarify the terminology and focus of this report.

First, with regard to terminology, the report generally refers to the collective problems experienced by NPOs as "access to financial services" rather than derisking. Financial access is a more appropriate characterization because the difficulties charities encounter are much broader than merely restricting or terminating accounts or failing to take on NPOs as clients. They also include delays in processing transfers, requests for additional information and other complicating actions. However, because derisking has become a common catch-all term, it is unavoidable in discussing the issues addressed in this report, especially in the context of previous reports and public characterizations.

Second, this report is focused solely on NPOs. Problems with correspondent banking relationships and MSBs have received significant attention in policy discussions and multilateral fora and have been highlighted in other studies. Difficulties in the correspondent banking and MSB sectors undoubtedly contribute to the current problems NPOs are experiencing. A reduction in correspondent banking relationships makes it more difficult for charities to move money internationally, and MSBs have become an alternative to the formal financial sector. However, the unique obstacles faced by NPOs in accessing financial services remain the exclusive focus of this report.

Third, for purposes of this report, NPOs are defined according to the IRS's definition of charitable activity,[16] which includes major humanitarian aid organizations, human rights groups and funds, friendship societies, faith-based organizations, environmental groups, museums, hospitals and universities. These organizations provide direct services (such as Save the Children or Doctors Without Borders) and conduct advocacy (such as the ACLU or Amnesty International). Foundations, including public grantmaking organizations (such as community foundations or Global Fund for Women) and private grantmaking organizations (such as the Ford Foundation), are also included in the scope of NPOs. The broad charity and foundation community is therefore included under the term NPOs. It should be noted that "NPOs" and "charities" are used interchangeably throughout this report.

Finally, the information and data presented in this report are intended to help facilitate an informed dialogue with regulators, policymakers, the financial community and the broader public. The report does not purport to be definitive in its assessments, but rather provides the first empirical information upon which informed discussion of solutions, as well as additional research, can be based. While further analysis will be useful in understanding the issues with finer granularity, the evidence presented in this report underscores the immediacy of the problem and the need to address these issues now. For the first time, we now know the scope and nature of the difficulties American nonprofits are experiencing with financial access, as well as some of the consequences of these problems. The work of nonprofits benefits broad foreign policy and security objectives, and this report should be read as a call to action for all stakeholders to reassess policies and work together to more effectively promote the multiplicity of U.S. interests.

16 A 501(c)(3) organization, also colloquially known as a 501c3, is a United States nonprofit organization that has been approved by the Internal Revenue Service to be tax-exempt if its activities have the following purposes: charitable, religious, educational, scientific, literary, testing for public safety, fostering amateur sports competition, or preventing cruelty to children or animals. See IRS, Exempt Purposes - Internal Revenue Code Section 501(c)(3), https://www.irs.gov/charities-non-profits/charitable-organizations/exempt-purposes-internal-revenue-code-section-501c3.

SECTION ONE BACKGROUND

Chapter 1
METHODOLOGY

This study was undertaken as an investigation aimed at assessing the scope and nature of financial problems experienced by nonprofit organizations that work in foreign countries. Rather than test a hypothesis, the research was designed to discover the basic information necessary for stakeholders in the government, financial and nonprofit sectors to engage in constructive future dialogue and action. This approach required the production of empirically sound data as well as information from focus groups, stakeholder interviews and desk research. This chapter describes the methodology used.

Systematic Random Sample of Defined U.S. NPOs

The Charity & Security Network commissioned the Schar School of Policy and Government at George Mason University (GMU) to design a survey of U.S.-based NPOs that conduct work in foreign countries in order to produce reliable and valid data to be combined with more qualitative information. Professors Delton T. Daigle and Stefan Toepler led the survey team.[17]

The study defined "nonprofit organizations" by utilizing the IRS definition for organizations claiming tax-exempt status as public charities under Section 501(c)(3) of the Internal Revenue Code. According to the IRS, exempt purposes are:

> "Charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term *charitable* is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency."[18]

17 The data used in this report will be made publicly available in the coming months. Contact the Charity & Security Network to obtain the data.

18 IRS, Exempt Purposes - Internal Revenue Code Section 501(c)(3), www.irs.gov/charities-non-profits/charitable-organizations/exempt-purposes-internal-revenue-code-section-501c3.

Most NPOs that claim tax-exempt status must annually file IRS Form 990, which includes information on governance, finances and activities. NPOs that perform services or conduct any form of financial transaction outside the U.S. must also complete Schedule F, "Statement of Activities Outside the United States."[19] Religious organizations or their associations or auxiliaries, private foundations, governmental units, pension funds, organizations organized by Congress or charities with revenue of $50,000 or less are exempt from these requirements.[20]

For this study, the universe of NPOs from which the random sample was drawn was determined by the availability of an organization's most recent Form 990 Schedule F filing. These were obtained through Guidestar,[21] a nonprofit that collects, organizes and maintains a database of information on nonprofit organizations. In most cases, organizations' 2014 filings were available, but in some cases, NPOs did not submit their forms in a timely manner, so their most recent filing is for 2013. In order to have as accurate a total universe as possible, forms from 2013 were used for the NPOs for which the more recent forms were not yet available. This was done to prevent any duplication of forms for any organization. Therefore, the universe of NPOs was defined as: *IRS Form 990 Schedule F filers with at least one unique tax filing in the fiscal years of 2013 or 2014.*

With the universe so defined, the target population was determined to be 8,665 unique organizations.

From this population of 8,665 organizations, GMU drew a random sample of 1,010 organizations. To obtain this sample, employee identification numbers (EINs) were randomized through the statistical analysis software program STATA using a randomly selected seed number and then sampling the 1,010 EINs. The EINs were then matched to these organizations' Form 990 filings, including Schedule F. A number of variables or fields, such as organization characteristics (including assets, revenues, number of employees and activities, as well as organization contact information), were purchased from Guidestar by C&SN for the purpose of this research.[22]

C&SN then commissioned GMU's Center for Social Science Research to conduct telephone interviews with a random sample of U.S.-based NPOs pulled from the Guidestar database. Telephone interviews were conducted with financial officers or other high-level organization representatives from late July through September 2016. The survey data in this report were obtained from the 305 NPOs that completed the phone interview (see survey questions in Appendix B). The survey's response rate of 38.2% meets the standards of the American Association of Public Opinion Research (AAPOR) for statistically reliable findings.

Because the Form 990 Schedule F filings were available for the total population of 8,665 charities with international activities, a rich comparison could be made between the total population and

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19 IRS, Schedule F (Form 990), Statement of Activities Outside the United States, 2016, www.irs.gov/pub/irs-pdf/f990sf.pdf.

20 IRS, *Annual Exempt Organization Return: Who Must File*, www.irs.gov/charities-non-profits/annual-exempt-organization-return-who-must-file.

21 Guidestar collects information on all organizations filing an IRS Form 990. These IRS forms represent the most complete source of information on the universe of U.S.-based nonprofits. *Guidestar, About Us: Guidestar's Mission*, https://learn.guidestar.org/about-us/.

22 Guidestar provided the Form 990, including Schedule F, and processed the sampling as proscribed by C&SN.

the sample of 1,010 to determine the degree to which the responding NPOs (305) represented the entire sample. It was determined that the sample was representative with two qualifications. First, smaller organizations were more likely to complete the interviews than larger organizations. Second, a very small number of hospitals, university foundations and similar organizations ("outliers") account for 75% of the total revenues of all organizations. For most of the data presentation, the differences were not statistically significant; only marginal differences (<2 percentage points) were observed. Where the difference was statistically significant (e.g., revenues and assets), the "traditional charities" were displayed separately from the "outliers." *Most importantly*, the findings from this study can be generalized to the total population from which this sample was drawn.

The response rate of 38.2% is relatively high for a standard telephone survey. The Schar School calculated that within a 95% confidence level, the data in Chapter 4 can be considered valid and representative of the NPOs that filed an IRS Form 990 and Schedule F for the year 2014 or 2013. The maximum margin of error for this survey is conservatively estimated at 5.4%.

Focus Groups

While empirical data are crucial to understanding what is happening in an effort to determine future policies, qualitative data are equally important. To collect this qualitative data, C&SN conducted five formal focus group sessions with various stakeholders: grantmakers, NPO treasurers, directors or executives of Muslim or Syrian-focused charities, university treasurers and bankers. The numbers of attendees at these sessions ranged from 4 to approximately 35.

The focus group discussions were conducted under the *Chatham House Rule:* no statements would be attributed to any organization or individual (all were anonymous). As expected, the comments and discussion greatly enriched the analysis and recommendations in this report. Most of the comments and quotes throughout this report are from these meetings.

Stakeholder Meetings

To ensure that the research addressed the questions and concerns of major stakeholders, interviews were conducted early in the research process with experts in government, experts in the financial sector, former regulators and nonprofit leaders. Trade associations and umbrella groups were also contacted. These interviews were also conducted under the Chatham House rule. Interviews with government agencies included multiple bureaus of the State and Treasury Departments, the National Security Council, the Office of Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), and United States Agency for International Development (USAID).