Research Paper

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Humanitarian Action and Non-state Armed Groups
The Impact of Banking Restrictions on UK NGOs

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Summary

- British NGOs undertaking humanitarian operations in or near areas where non-state armed groups (NSAGs) are active face increasing restrictions on their access to the financial system, including delayed transfers, the freezing of funds and in some cases the complete closure of bank accounts. These restrictions impede the UK government's ability to meet its commitment under the 2015 National Security Strategy and Strategic Defence and Security Review to refocus its aid budget to support fragile and broken states and regions.
- The perception of NGOs as 'high risk' can be traced in part to Recommendation 8 (originally Special Recommendation VIII) of the Financial Action Task Force (FATF). Drawn up after 9/11, this recommendation until recently described NGOs as being particularly vulnerable to misuse for terrorist financing, contributing to highly cautious behaviour by banks.
- Since the global financial crisis, banks have been subject to far tougher regulatory and enforcement regimes for non-compliance. This has resulted in a diminishing appetite for risk, hitting humanitarian NGOs acutely, as banks have shifted away from clients perceived to present the greatest risk of terrorism financing and money laundering.
- Banks are crucial partners for the authorities in the implementation of international sanctions and counterterrorism legislation. For UK-based humanitarian NGOs, this presents the challenge of dealing not only with UN and EU sanctions but also with the extraterritorial reach of the US, as banks seek to ensure that funds and aid are not diverted to designated individuals and NSAGs. While licensing programmes for such humanitarian activity do exist, they have had little meaningful impact as yet on NGOs and their ability to navigate the financial system.
- Humanitarian NGOs generally accept the need for regulation and due diligence, but the current weight of compliance demands by their banking partners is often seen as disproportionate, resulting in a need to spend donor money on additional staff and due diligence tools, increased administration costs, aid delivery and financial transfer delays, and in some circumstances the closure of programmes to which funding cannot be delivered.
- Donors, particularly government agencies such as DFID, appear to have done little to alleviate this burden of compliance, leaving the responsibility for the due diligence required for funds transfers with humanitarian NGOs operating in high-risk zones.
- Banks and NGOs must cultivate relationships – with the support of the Charity Commission – that allow for reciprocal education regarding compliance expectations on the part of the former, and the operating risks and mitigation steps being taken by the latter.
- The UK government is encouraged to take ownership of this challenge, providing guidance and clear messaging where ambiguity exists as regards sanctions and counterterrorism legislation, while championing the important work that humanitarian NGOs undertake. This means publicly stating that aid delivery is a key government commitment and one that the banking sector must support, as well as establishing the long-overdue working group to ensure that these issues are addressed as a priority.

Introduction

NGOs are confronted by ever increasing restrictions on their access to, and use of, financial services. News reports and research studies[1] frequently document account closures and payment delays, and these are just from the small number of NGOs that choose to publicize such constraints. Thus, the purpose of this paper is to consider the impact of banking sector restrictions on UK-registered humanitarian actors conducting humanitarian operations abroad. As research conducted[2] for this paper reveals, and supported by previous work undertaken by one of the authors,[3] many UK-registered NGOs are faced with unreported financial restrictions and an increasing bureaucratic burden placed on them by banks. Those most affected are frequently, although not exclusively, humanitarian NGOs active in or near those areas where non-state armed groups (NSAGs) designated under sanctions regimes or counterterrorism measures are based or operate, potentially impeding these NGOs' ability to provide essential services, pay staff and suppliers, and receive donations.

In its November 2015 National Security Strategy and Strategic Defence and Security Review,[4] the UK government committed to '… use our formidable development budget and our soft power to promote British values and to tackle the causes of the security threats we face, not just their consequences. *This includes refocusing our aid budget to support fragile and broken states and regions to prevent conflict* [*authors' emphasis*].' Paradoxically, it is often government funds (from the UK Department for International Development – DFID), disbursed in support of NGO-implemented programmes, that are being blocked from transfer in support of this endeavour.[5] As noted in 2015 by the UK Joint Parliamentary Committee established to consider the draft Protection of Charities Bill, the risk that UK NGO activities overseas are subject to a 'chilling effect' comes 'at a time when their efforts are possibly more critical than ever before'.[6]

At the heart of this challenge lies the banking sector, a privately owned, profit- and shareholder-value-driven industry that has adapted its business model and operating standards considerably in recent years because of increased domestic and international regulation, greater operating and capital costs imposed by these regulations (resulting in reduced profitability), and in some cases, major fines imposed by regulators and prosecutors – particularly from the US – following non-compliance with the regulatory framework. These pressures on banks have in turn led to an increase in risk-aversion. Clients operating in high-risk jurisdictions, for example within or near areas where designated NSAGs are based or operate, and where diversion of aid or payments to such groups is a possibility, inevitably attract additional scrutiny. And clients deemed to be high risk – such as NGOs operating in these areas – are at best subject to a significant increase in regulatory compliance and disclosure requirements (with a commensurate increase in operating costs to comply with these requirements), as banks require NGOs to provide ever greater amounts of information about themselves, their transactions and their aid programmes. At worst they lose financial access, with a range of implications from delayed receipt of donations or disbursement of funds, to the closure

[1] Eckert, S. (2017), *Financial Access for Nonprofit Organizations: An Evidence Base for Policy Action,* Charity & Security Network.
[2] A workshop with NGOs was held on 29 September 2016, and a further roundtable discussion took place on 23 November 2016.
[3] Keatinge, T. (2014), *Uncharitable Behaviour*, London: DEMOS, www.demos.co.uk/files/DEMOSuncharitablebehaviourREPORT.pdf; Metcalfe-Hough, V., Keatinge, T., and Pantuliano, S. (2015), *UK Humanitarian Aid in the Age of Counter-terrorism: Perceptions and Reality*, London: Overseas Development Institute, www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9479.pdf.
[4] HM Government (2015), *National Security Strategy and Strategic Defence and Security Review 2015*, www.gov.uk/government/uploads/system/uploads/attachment_data/file/478933/52309_Cm_9161_NSS_SD_Review_web_only.pdf.
[5] The UK government distributes 20 per cent of its bilateral overseas development assistance budget through NGOs: Department for International Development (2016), 'Guidance: Civil Society Partnership Review – FAQs', updated 15 January 2016, www.gov.uk/government/publications/civil-society-partnership-review/civil-society-partnership-review-faqs#how-much-does-dfid-currently-spend-through-csos.
[6] Joint Committee on the Draft Protection of Charities Bill (2015), *Draft Protection of Charities Bill: Report*, 25 February 2015.

of aid programmes because of blocked funds transfers. For example, one NGO reported having been informed by a bank that as Syria is a conflict zone where a large number of designated NSAGs are based or operate, it was impossible to guarantee that funds required for planned projects would not be diverted and thus transfers to Syria were above the bank's risk threshold and would not be processed.[7] A consequence is that humanitarian NGOs are increasingly devising their aid programmes according to financial access rather than need. As one NGO noted, the tail is wagging the dog.

The original source of these restrictions was the aftermath of the 9/11 attacks on the mainland US, and the global counterterrorism finance campaign launched by the administration of President George W. Bush as part of the 'war on terror'. This campaign, and bodies such as the Financial Action Task Force (FATF) co-opted to prosecute these objectives, identified NGOs as being 'particularly vulnerable' to abuse by terrorist financiers, triggering global scrutiny of the sector's operations and finances.[8]

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The result, in combination with the more general regulatory pressure applied to the banking industry following the global financial crisis in 2008, is that a decade-and-a-half after President Bush signed Executive Order 13224, launching 'a strike on the financial foundation of the global terror network' in order to 'starve the terrorists of funding',[9] humanitarian NGOs are faced with ever increasing banking pressures.[10]

From the research conducted for this paper, and despite the reluctance of NGOs to provide quantitative data, it is apparent that banking restrictions on humanitarian NGOs have resulted in delayed transfers, the freezing of funds, and even the total closure of bank accounts of NGOs trying to implement aid programmes. This is particularly the case where these programmes operate in or near areas where designated NSAGs are based or operate. As a result, some have had to scale down vital humanitarian programmes, or close them altogether. In addition, humanitarian NGOs have had to adapt rapidly to the banking sector's augmented compliance demands, meaning that extra staff, additional hours, and more training and legal advice are required, at a significant cost to an already burdened sector.

British Muslim humanitarian NGOs are particularly affected by financial restrictions applied by banks in the UK and abroad. A range of factors are believed to be at the root of this, perhaps most pertinently that suspicion towards Muslim NGOs is founded on a small number of historical cases of Muslim charities being used to raise and move money for designated terrorist groups. For example, in 2011 UK police and security forces uncovered a plot to detonate explosives across Birmingham. Physical surveillance revealed that the architects of the plot had financed themselves by posing as charity workers for Muslim Aid, gathering £12,000 in donations.[11] The charity itself, which was informed of the deception after the arrests had been made, subsequently worked closely with the

[7] Authors' interview (September 2016).
[8] This wording is shown at Financial Action Task Force (2017), 'IX Special Recommendations', www.fatf-gafi.org/publications/fatfrecommendations/documents/ixspecialrecommendations.html.
[9] US Department of the Treasury (2002), *Contributions by the Department of the Treasury to the Financial War on Terrorism: Fact Sheet*, www.treasury.gov/press-center/press-releases/Documents/2002910184556291211.pdf.
[10] While peacebuilding NGOs also report instances of financial restriction, this paper focuses primarily on humanitarian NGOs for which the movement of funds is key to the delivery of aid programmes.
[11] BBC News (2013), 'Terror plot: Jail terms for Birmingham bomb plotters', 26 April 2013, www.bbc.co.uk/news/uk-22290927.

Charity Commission for England and Wales to strengthen its safeguards and prevent future abuse.[12] Nonetheless, cases such as this[13] are particularly damaging to the reputation of NGOs, regardless of the checks and balances that may have since been put in place.

This issue has been subject to renewed focus in the context of the Syrian conflict, which has reinforced the notion that Muslim humanitarian NGOs in particular are at greatest risk of terrorist abuse, given their large operational presence in regions assessed by banks as being high risk as they are within or near those areas where designated NSAGs are based or operate.[14]

The UK government must grapple with two clearly conflicting priorities: its commitment to overseas humanitarian aid in conflict zones (for example, the commitment made in February 2016 to provide aid worth an additional £1.2 billion to Syria and the surrounding region of Lebanon, Turkey and Jordan in 2016–20[15]); and simultaneously ensuring that money and resources do not end up in the hands of designated NSAGs. Meanwhile, the banking sector's diminishing tolerance for the risks associated with moving money to these jurisdictions stands at odds with the desire articulated by the UK government to deliver aid to areas most affected by conflict and instability.

Assessing the case of UK-registered, internationally operating humanitarian NGOs, this paper[16] begins by presenting the regulatory framework that has contributed to the banking sector adopting a more restrictive approach, leading to limitations on services provided to NGOs that operate in situations of armed conflict and, particularly, areas where designated NSAGs operate or hold influence. It then analyses the impact of this changing and challenging financial environment on humanitarian NGOs, supplemented with information shared with the authors by internationally operating UK-registered humanitarian NGOs that have first-hand experience of these difficulties.

There are two elements central to the challenge. First, the rational and defensive actions of banks asked to move funds for NGO activity where designated NSAGs operate and where the risk of diversion is high; and second, the seemingly irrational and disproportionate actions of banks in apparent overcompensation for their regulatory and governance failings of the past, coupled with a lack of understanding of how humanitarian NGOs operate and manage their risks. In both cases, if the UK government is genuine in its commitment to assist 'broken and fragile states', then it must support NGOs operating in or near areas where designated NSAGs are based or operate. It must make greater efforts to include exemptions for humanitarian action in international sanctions, and issue general licences and guidance in relation to contexts where such exemptions do not exist. The government must also determine whether the delivery of aid is more important than the risk that some aid may be diverted.

[12] Financial Action Task Force (2014), *Risk of Terrorist Abuse in Non-Profit Organisations,* www.fatf-gafi.org/media/fatf/documents/reports/Risk-of-terrorist-abuse-in-non-profit-organisations.pdf, p. 33.

[13] For further UK examples, see Dipesh Gadher (2016), 'Terror links of UK charity funded by primary pupils selling cupcakes for Syria', *The Times,* 31 July 2016, www.thetimes.co.uk/article/terror-links-of-uk-charity-funded-by-primary-pupils-selling-cupcakes-for-syria-97qzkg083; Charity Commission (2014), 'Children in Deen under inquiry', 30 April 2014, www.gov.uk/government/news/children-in-deen-under-inquiry; Charity Commission (2014), 'Charity regulator opens inquiry into Al-Fatiha Global', 3 April 2014, www.gov.uk/government/news/charity-regulator-opens-inquiry-into-al-fatiha-global; and Charity Commission (2014), 'Watchdog opens investigation into two charities set up to help deliver aid to Syria', 29 January 2014, www.gov.uk/government/news/watchdog-opens-investigation-into-two-charities-set-up-to-help-deliver-aid-to-syria.

[14] Such areas include, in addition to Syria, Afghanistan, Iraq, South Sudan and Yemen.

[15] Prime Minister's Office, 10 Downing Street, Department for International Development, The Rt Hon David Cameron MP (2016), 'UK to invest an extra £1.2 billion supporting Syria and the region', press release, 4 February 2016, www.gov.uk/government/news/uk-to-invest-an-extra-12-billion-supporting-syria-and-the-region.

[16] This paper complements another paper recently published by Chatham House: Jones, K. (2017), *Humanitarian Action and Non-state Armed Groups: The UK Regulatory Environment*, Research Paper, London: Royal Institute of International Affairs, www.chathamhouse.org/publication/humanitarian-action-and-non-state-armed-groups-uk-regulatory-environment.

Regulatory Challenges

In conducting its business, the banking sector must comply with a range of domestic and international legislation and guidance that affects its decision-making. As regards terrorism and terrorist financing, since two earlier papers in this series, by Emanuela-Chiara Gillard and Kate Jones, provide detailed assessments of the overarching legal frameworks, including sanctions and relevant counterterrorism legislation,[17] this paper will consider only those elements that impact the relationship between NGOs and their banks.

The international framework

The international framework for securing the integrity of the financial sector against all forms of financial crime, including terrorist financing, is provided by the recommendations of the FATF.[18] As it relates to NGOs, the FATF outlines the risk of terrorist abuse to what it terms 'non-profit organisations' (NPOs) through Recommendation 8 (originally Special Recommendation VIII), one of the 'Special Recommendations' drawn up after its mandate was expanded following the 9/11 attacks to include countering terrorist financing. In the FATF's original wording, NGOs 'possess characteristics that make them particularly attractive to terrorists or vulnerable to misuse for terrorist financing' including the fact that they enjoy public trust, have access to considerable sources of funds, and operate cash-intensive activities across borders and often in or near areas where designated NSAGs are based or operate.[19]

For 15 years after 9/11, this assessment led the FATF's Recommendation 8 to state:

> Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they cannot be misused:
>
> a) by terrorist organisations posing as legitimate entities;
>
> b) to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset-freezing measures; and
>
> c) to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations.

The wording of Recommendation 8 was heavily criticized, as awareness of its existence spread and its influence was seemingly used to crack down on civil society 'to ensure that they cannot be misused'.[20] Specifically, the phrase 'particularly vulnerable' raised exceptional concern as charities asserted that it overstated the risk posed by the majority of NGOs and conflated risk (which few NGOs dispute) with actual abuse, abuse that has certainly occurred but which is not as prevalent as this wording would suggest.[21] There is no doubt that the perceived vulnerabilities of NGOs to abuse for the financing of terrorism is a perception shared among banks, contributing to their reduced appetite to offer services

[17] Gillard, E. (2017), *Humanitarian Action and Non-state Armed Groups: The International Legal Framework*, Research Paper, London: Royal Institute of International Affairs, www.chathamhouse.org/publication/humanitarian-action-and-non-state-armed-groups-international-legal-framework; Jones, K. (2017) *Humanitarian Action and Non-state Armed Groups: The UK Regulatory Environment*.
[18] The FATF was founded in 1989 as a response to the laundering of the proceeds of the Latin American narcotics industry. Since 9/11 it has also led the global response to terrorist financing. The FATF seeks to raise global standards by assessing compliance with and implementation of its 40 Recommendations and 11 Immediate Outcomes, highlighting those countries with shortcomings and monitoring the resulting remedial action.
[19] Financial Action Task Force (2008), *Terrorist Financing*, Paris: FATF/OECD.
[20] For a good explanation of this growing awareness, see Ben Hayes (2012), *Counter-terrorism, 'policy laundering' and the FATF: Legalising Surveillance, Regulating Civil Society*, Amsterdam and Paris: Transnational Institute and Statewatch, www.tni.org/en/publication/counter-terrorism-policy-laundering-and-the-fatf.
[21] For a review of NGO terrorist financing abuse case studies, see Financial Action Task Force (2014), *Risk of Terrorist Abuse in Non-Profit Organisations*.

to the sector. The FATF's Interpretive Note to Recommendation 8 has, since inception, sought to provide nuance to this recommendation, advising that 'measures adopted by countries to protect the NPO sector from terrorist abuse should not disrupt or discourage legitimate charitable activities',[22] but the headline message of the recommendation issued following 9/11 was clear: NGOs are a high-risk sector.

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Belatedly, since 2013, the FATF has engaged with the NGO community and sought to address its concerns, as the negative and repressive impact of Recommendation 8 has been highlighted not just by NGOs themselves, but also by a range of high-level individuals including the UN Special Rapporteur on the rights to freedom of peaceful assembly and of association, Maina Kiai, who argued that Recommendation 8 posed 'a serious, disproportionate and unfair threat to those who have no connection with terrorism, including civil society organizations.'[23] The FATF has subsequently produced a typologies report on 'the threat to the NPO sector from terrorist entities, the drivers for this threat, the vulnerabilities in the sector, and complexities facing stakeholder responses',[24] and an updated Best Practices Paper;[25] and, in June 2016, it removed the reference to NPOs being 'particularly vulnerable' to terrorist abuse[26] entirely from Recommendation 8 and updated the accompanying Interpretive Note.[27] The modification was widely lauded by the sector, and many hailed it as a considerable victory[28] for NGOs in a space in which it has become increasingly difficult to operate. However, as this paper further explores, the financial restrictions encountered by NGOs continue to increase.

Sanctions and counterterrorism legislation

In addition to having regard for the FATF recommendations, banks are also key actors in the implementation of sanctions and counterterrorism legislation, and their obligations in this regard affect their business decisions.

The use of sanctions on a multilateral, regional or unilateral basis has grown significantly over the past 25 years.[29] Given that humanitarian NGOs often operate in countries subject to sanctions or in or close to areas where designated individuals or NSAGs are based or operate, managing risks related to providing financial services to NGOs operating in such areas is a key challenge for banks, and is consistently identified by humanitarian NGOs as impacting their ability to conduct banking.[30]

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[22] Financial Action Task Force (2015), *Best Practices Paper on Combating the Abuse of Non-Profit Organisations (Recommendation 8),* www.fatf-gafi.org/publications/fatfrecommendations/documents/bpp-combating-abuse-npo.html.
[23] UN General Assembly (2014), *Report of the Special Rapporteur on the Rights to Freedom of Peaceful Assembly and of Association (A/69/365)*, 1 September 2014, p. 10.
[24] Financial Action Task Force (2014), *Risk of Terrorist Abuse in Non-Profit Organisations.*
[25] Financial Action Task Force (2015), *Best Practices Paper on Combating the Abuse of Non-Profit Organisations (Recommendation 8)*.
[26] The Non Profit Platform on the FATF, http://fatfplatform.org/announcement/fatf-revises-recommendation-8/.
[27] This evolution will be explored in detail in Romaniuk, P. and Keatinge, T. (2017, forthcoming), 'Protecting charities from terrorists … and counter terrorists: FATF and the global effort to prevent terrorist financing though the non-profit sector', *Crime, Law and Social Change.*
[28] Dobichina, I. (2016), 'The Big Impact of the Little-Known "Recommendation 8"', 11 July 2016, www.opensocietyfoundations.org/voices/big-impact-little-known-recommendation-8.
[29] For a detailed analysis, see Graduate Institute of International and Development Studies (2016), 'Targeted Sanctions Initiative', http://graduateinstitute.ch/un-sanctions.
[30] For a detailed review, see Walker, J. (2016), *Humanitarian Impact of Syria-Related Unilateral Restrictive Measures*, report prepared for the UN Economic and Social Commission for Western Asia, https://assets.documentcloud.org/documents/3115191/Hum-Impact-of-Syria-Related-Res-Eco-Measures-26.pdf.

It is not only UN or EU sanctions that impact UK-based humanitarian NGOs. The disruptive role played by US implementation of UN or unilateral sanctions is also overbearing, as the extraterritorial reach of the Office of Foreign Assets Control (OFAC), the US sanctions enforcement body located within the US Treasury Department, has a pivotal role in shaping not just US but also international banking behaviour. OFAC's extraterritorial reach stems from the fact that as most dollar-denominated transactions pass through the US, even if both sender and recipient are located outside the US, these transactions are within OFAC's jurisdiction.

The risk for the banking sector is very real. Failure to comply can lead to punitive action including fines, loss of US banking licences, or even being sanctioned and designated a 'primary money laundering concern' by OFAC, under Section 311 of the USA PATRIOT Act,[31] and thereby losing access to the US financial system. In June 2014, for example, BNP Paribas was fined a total of $8.9 billion for illegally processing financial transactions for countries subject to US economic sanctions, including Sudan, Iran and Cuba, and removing references to sanctioned entities from payment messages to enable the funds to pass through the US financial system undetected.[32] In another case (subsequently reversed), in 2015 the US Treasury's Financial Crimes Enforcement Network (FinCEN) named Banca Privada d'Andorra (BPA) as a foreign financial institution of primary money laundering concern, pursuant to Section 311 of the USA PATRIOT Act, based on the belief that senior managers at BPA knowingly facilitated transactions on behalf of third-party money launderers acting for transnational criminal organizations.[33] The effect on BPA, despite the subsequent reversal, was to exclude it from any transactions denominated in US dollars as its US correspondent banks immediately froze its accounts;[34] the bank's Spanish unit was liquidated, and the parent bank was placed under the control of the Andorran authorities.[35]

Sanctions enforcement bodies such as OFAC and the UK's Office of Financial Sanctions Implementation (OFSI) may issue licences to NGOs to conduct activities that would otherwise be precluded by sanctions.[36] In the case of OFAC, these licences can either be 'general' or 'specific': the former authorize a particular type of transaction for a class of persons without the need to apply for a transaction-related licence; the latter are issued to a particular person or entity, and authorize a particular transaction in response to a written licence application. In June 2013, for example, OFAC issued a general licence authorizing certain services in support of NGO activities in Syria, including activities to support humanitarian projects.[37]

OFAC's guidance related to the provision of humanitarian assistance by NGOs states:

> OFAC is fully supportive of the broader U.S. Government approach to facilitating humanitarian assistance. The President's imposition of economic sanctions against regimes or groups carrying out violence against innocent civilians is a complement to – and not in opposition to – the objectives of humanitarian assistance.[38]

[31] For further details of Section 311, see www.treasury.gov/resource-center/terrorist-illicit-finance/311-Actions/Pages/311-Actions.aspx.
[32] US Department of Justice Office of Public Affairs (2014), 'BNP Paribas Agrees to Plead Guilty and to Pay $8.9 Billion for Illegally Processing Financial Transactions for Countries Subject to U.S. Economic Sanctions', press release, 30 June 2014, www.justice.gov/opa/pr/bnp-paribas-agrees-plead-guilty-and-pay-89-billion-illegally-processing-financial.
[33] US Department of the Treasury Financial Crimes Enforcement Network (2015), 'FinCEN Names Banca Privada d'Andorra a Foreign Financial Institution of Primary Money Laundering Concern', press release, 10 March 2015, www.fincen.gov/news/news-releases/fincen-names-banca-privada-dandorra-foreign-financial-institution-primary-money.
[34] Chon, G. (2015), 'Andorran bank hits back at US regulators', *Financial Times*, 7 October 2015, www.ft.com/content/169c65b2-6cf0-11e5-aca9-d87542bf8673.
[35] *The Economist* (2015), 'Banks and money-laundering: A fearful number', 6 June 2015, www.economist.com/news/finance-and-economics/21653673-bank-rejects-american-accusations-it-abetted-financial-crime-fearful.
[36] OFAC makes available a set of frequently asked questions at www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#licenses.
[37] US Department of the Treasury Office of Foreign Assets Control (2013), 'Syria General License No. IIA: Authorizing Certain Services in Support of Nongovernmental Organizations' Activities in Syria', www.treasury.gov/resource-center/sanctions/Programs/Documents/syriagl11a.pdf.
[38] US Department of the Treasury Office of Foreign Assets Control (2014), 'Guidance related to the provision of humanitarian assistance by not-for-profit non-governmental organizations', available at www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/ngo_humanitarian.pdf.

The guidance acknowledges that 'some humanitarian assistance may unwittingly end up in the hands of members of a designated group', but states that such 'incidental benefits are not a focus of OFAC sanctions enforcement'. Furthermore, OFAC emphasizes its prioritization of processing of licence requests for humanitarian assistance.[39]

Often, however, the licensing regimes have limited positive impact on NGOs and their banking relationships. The fact that a licence is needed suggests to banking partners that the business being conducted by the NGO is 'close to the edge' and therefore risky. Furthermore, licences can take months to procure, and when received the complexities and variation of sanctions regimes in different countries makes the functioning of licences extremely complex. OFAC's most recent release of quarterly reports related to all licensing activities[40] paints a picture of increasing delay. The release, covering the second, third and fourth quarters of 2015, indicates that average licence processing times, for those acted on, were respectively 71, 77 and 88 business days, for the three quarters respectively, equating to 14, 15 and 18 weeks, with 328 of the 622 licence applications made in that period not being processed at all.

Just as sanctions have a significant adverse effect on the willingness of banks to provide financial services to NGOs, so does counterterrorism legislation. Humanitarian NGOs may be committing a serious offence if they raise funds that are then diverted to designated NSAGs, or if, as part of their operations, they make registration or other payments to such groups or to individuals associated with them. OFSI has explicitly ruled that it will not license taxes or fees paid to a designated group, even if such payments are required in order for an NGO to operate within a conflict zone.[41] It is of course virtually impossible for humanitarian NGOs to ensure that funds or resources will not end up in the hands of a designated individual or NSAG, particularly when operating in conflict zones, or in or near areas where designated NSAGs are based or operate.

A 2016 Home Office/HM Treasury 'for information note',[42] in its explanation of why the UK has not introduced a specific exemption from prosecution under UK counterterrorism legislation for staff of NGOs engaged in humanitarian and/or conflict resolution work, advises that prosecutors are required 'to consider the seriousness of the offence, the culpability of the alleged offender and the harm caused when determining whether a prosecution is required in the public interest'. The UK's Independent Reviewer of Terrorism Legislation has drawn attention on a number of occasions to the negative impact that cautious interpretations by banks of counterterrorism legislation can have on overseas aid. In 2014, for example, David Anderson QC noted: 'There is a risk that necessary anti-terrorism laws will be given a bad name if they result in avoidable restrictions on the ability of NGOs to conduct vital humanitarian and peacebuilding operations in parts of the world from which terrorism emanates.'[43] That report highlighted the NGO sector's concerns that banks were withdrawing services from NGOs, resulting in the delay or total block of necessary funds. Anderson also recommended that a dialogue be initiated between international NGOs and policymakers to explore how the objectives

[39] Ibid.
[40] US Department of the Treasury Resource Center, '2nd, 3rd and 4th Quarter FY2015 Reports for Licensing Activities Undertaken Pursuant to the Trade Sanctions Reform and Export Enhancement Act of 2000 (TSRA)', www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20160915_33.aspx.
[41] Office of Financial Sanctions Implementation, HM Treasury (2016), *Financial Sanctions: Guidance*, www.gov.uk/government/uploads/system/uploads/attachment_data/file/576291/OFSI_Financial_Sanctions_-_Guidance_-_December_2016.pdf, p. 39.
[42] Home Office and HM Treasury Office of Financial Sanctions Implementation (2016), 'For information note: operating within counter-terrorism legislation', www.gov.uk/government/publications/operating-within-counter-terrorism-legislation/for-information-note-operating-within-counter-terrorism-legislation.
[43] David Anderson QC (2014), *The Terrorism Acts in 2013*, https://terrorismlegislationreviewer.independent.gov.uk/wp-content/uploads/2014/07/Independent-Review-of-Terrorism-Report-2014-print2.pdf.

of counterterrorism legislation can be met without undue disruption of NGO activity.[44] While the UK government responded sufficiently for the Independent Reviewer to note in 2015 that a dialogue was in progress,[45] as discussed below, this process has apparently lacked momentum.

In its May 2016 report, *The World Humanitarian Summit: priorities for reform*, the House of Commons International Development Committee added its voice to those concerned that the unintended consequences of counterterrorism legislation have meant that NGOs are unable to operate effectively.[46] As underlined in a letter to the committee from Andrew Mitchell MP and Clare Short following a visit to the Syria–Turkey border, the impact of this legislation on transferring funds and implementing programmes is particularly acute for British Muslim humanitarian NGOs,[47] which have asserted that the measures disproportionately affect, and at worst actively target, them.

In 2006 more than 20 families filed claims against NatWest before US courts, alleging that it had knowingly allowed customers to move funds via Interpal to a Palestinian group linked to terrorism, and consequently that it bore some responsibility for various terrorist attacks in Israel.

A further consideration for banks when assessing the terrorist financing risks associated with providing financial services to humanitarian NGOs stems from the risk of *civil* litigation. The best-known case in the UK involves NatWest and Interpal, a UK-based charity founded in 1994 that works to help Palestinians in the Palestinian Territories, Lebanon and Jordan.[48] In 2003 the US government accused it of funding Hamas terrorist activity in the West Bank. It froze Interpal's US accounts and assets, and officially designated it a terrorist organization. Despite this US designation, Interpal remained free to operate in the UK: investigations by the Charity Commission for England and Wales concluded that there was insufficient evidence to support allegations of links between Interpal and Hamas,[49] while the then Financial Sanctions Unit of the Bank of England also reviewed the charity at NatWest's request, and confirmed that NatWest need not close its accounts.[50] In 2006 more than 20 families filed claims against NatWest before US courts, alleging that it had knowingly allowed customers to move funds via Interpal to a Palestinian group linked to terrorism, and consequently that it bore some responsibility for various terrorist attacks in Israel.[51] The lawsuits were initially dismissed in 2013, but were revived on appeal in September 2014. While no further trial date has been set, the time and money this case has cost NatWest are undoubtedly considerable, and such cases cause additional caution on the part of banks considering providing banking services to humanitarian NGOs working in conflict zones where designated NSAGs are based or operate.

[44] Ibid.
[45] David Anderson QC (2015), 'Terrorist Asset-Freezing in 2013/14', https://terrorismlegislationreviewer.independent.gov.uk/terrorist-asset-freezing-in-2013-14-march-2015.
[46] House of Commons International Development Committee, *World Humanitarian Summit: priorities for reform,* p. 33, www.publications.parliament.uk/pa/cm201516/cmselect/cmintdev/675/675.pdf.
[47] Ibid., p. 40.
[48] Interpal (2016), 'About Interpal', www.interpal.org/what-we-do/about-us/.
[49] Charity Commission (2009), Inquiry report: Palestinians Relief and Development Fund (Interpal).
[50] *Weiss v. Nat'l Westminster Bank PLC, 768 F.3d 202,* 204 *(2d Cir. 2014).*
[51] For further details of the lawsuit, see www.osenlaw.com/case/natwest-case.

Derisking

Any analysis of the banking sector's restrictive approach towards humanitarian NGOs must also include consideration of banks' diminished appetite for risk as a result of the global financial crisis of 2008; a tougher enforcement environment, particularly emanating from the US; and higher costs resulting from increased compliance expense. Increasingly, banking decisions are informed by a fear of violating regulations on sanctions, counterterrorism, money laundering, and bribery and corruption. Banks have consequently focused their priorities on areas of core business, shifting away from clients that, in their assessment, present a higher risk of money laundering and terrorist financing and offer limited returns in the form of profitability. This reassessment of business priorities, resulting in the closing or restricting of financial services, has become known as 'derisking'.[52] Humanitarian NGOs working in conflict zones where designated NSAGs are based or operate find themselves in this higher-risk category, and join a number of other sectors disproportionately affected by derisking. Adherence by banks to international standards is not only a legal obligation, but also a key means by which the flow of illicit funds such as those that use opaque structures to disguise the proceeds of corruption can be stopped. Yet, as the then US treasury secretary Jack Lew pointed out in October 2016: 'if the [regulatory] burden is so high that people withdraw from the financial system or are excluded from it, the risks of illicit transactions rises',[53] as financial flows move into an unregulated environment in which illicit activity can flourish.

Derisking has become especially pronounced following the historic fines imposed in recent years on financial institutions such as Standard Chartered, BNP Paribas and HSBC – in particular by multiple US regulators and agencies including OFAC and the New York Department of Financial Services – for serious breaches of US sanctions and regulations aimed at countering money laundering. In 2012, for example, HSBC was fined a record $1.9 billion for a range of failures that led to the laundering of at least $881 million, including proceeds of drug trafficking by the Sinaloa Cartel in Mexico and the Norte del Valle Cartel in Colombia.[54] The bank subsequently entered a five-year deferred prosecution agreement (DPA) with the US Department of Justice whereby it was to submit to oversight from a monitor. Inevitably, events such as this shape banks' attitude to risk, often leading them to determine that the perceived risks of continuing to provide banking services to NGOs operating within or near those areas that are most exposed to terrorist activity outweigh the benefits of offering services to this client segment.

The trend to derisk has also impacted correspondent banking services. For money to flow around the world, it is dependent on underlying mechanisms and architecture that facilitate the movement of value through a chain of correspondent banks.

The process whereby two banks are able to send money to one another via reciprocal deposit accounts is relatively simple within the boundaries of one country. It is far more complex, however, when funds are moved across international borders, resulting from the need to interpose one or more correspondent banks to act as conduits along the banking chain. Given the discrepancies in regulatory standards that may exist between different countries, correspondent banks need to be certain that

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[52] For an extensive review of this issue, see John Howell & Co Ltd for the Financial Conduct Authority (2016), *Drivers and Impacts of Derisking: A study of the representative views and data in the UK*, www.fca.org.uk/publication/research/drivers-impacts-of-derisking.pdf.
[53] Comments made by Jacob Lew at World Bank panel (2016): 'Financial inclusion not exclusion: managing de-risking', http://blogs.worldbank.org/voices/powerful-panel-weighs-progress-financial-inclusion.
[54] United States Department of Justice (2012), 'HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement', press release, 11 December 2012, www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations.

they are not facilitating the transfer of illicit funds from or to senders and recipients that they do not know. They may therefore opt to cut correspondent ties with banks operating in a higher-risk environment to protect against this eventuality, thus breaking the chain.

In its 2016 progress report to the G20 on the action plan to assess and address the decline in correspondent banking, the Financial Stability Board[55] noted:

> A decline in the number of correspondent banking relationships is a source of concern for the international community because it may affect the ability to send and receive international payments, or drive some payment flows underground, with potential consequences on growth, financial inclusion, as well as the stability and integrity of the financial system.[56]

In the view of the IMF, the marked increase in the rate of termination of correspondent relationships since the global financial crisis has particularly affected emerging markets and developing economies, as well as countries subject to sanctions.[57] Humanitarian NGOs rely on correspondent banking services to transfer aid-related funding for programme implementation and payment of staff abroad; any severing of these ties, as reported by one major NGO,[58] affects their ability to provide essential services and pay suppliers and staff salaries, with obvious negative consequences.

This combination of increased scrutiny of the sector and bank derisking has given rise to two sets of banking behaviour: first, necessary and proportionate measures driven by the real risk of aid diversion to designated entities or sanctions targets; and second, irrational and disproportionate measures driven by a fear of regulators and an overall lack of understanding of what humanitarian NGOs do and how they manage risk.

The UK landscape

In the UK's first national risk assessment of money laundering and terrorist financing, published by the Home Office and HM Treasury in 2015, terrorist financing risks within the charitable sector are classed as 'medium-high'. The assessment notes that since terrorists and charities operate in conflict areas, it can be difficult to determine the end destination of funds.[59] The guidance of the UK financial services industry's Joint Money Laundering Steering Group (JMLSG), which aims to promote good practice in countering money laundering, also provides examples of higher-risk situations in which UK banks should make 'more penetrating initial enquiries', including: 'unregistered charities based or headquartered outside the UK, 'foundations', cultural associations and the like, particularly if centred on certain target groups, including specific ethnic communities, whether based in or outside the UK'.[60] Advice such as this undoubtedly influences banks' internal risk assessments, adding to the financial challenges encountered by NGOs in providing humanitarian assistance in areas of armed conflict.

Despite the FATF's 2016 rewording of Recommendation 8, it appears unlikely that there will be any substantive reversal of derisking by UK banks as regards provision of services to NGOs in the foreseeable future, as the *perception* that NGOs may be a channel for terrorist financing will

[55] The Financial Stability Board (FSB) was formed in 2009 by the G20 to expand the existing Financial Stability Forum created by the G7 in 1999. The FSB promotes international financial stability by reviewing regulation, assessing vulnerabilities, and monitoring and advising on market developments: see www.fsb.org/about/.
[56] Financial Stability Board (2016), *Progress report to G20 on the FSB action plan to assess and address the decline in correspondent banking,* www.fsb.org/wp-content/uploads/Progress-report-to-G20-on-the-FSB-action-plan-to-assess-and-address-the-decline-in-correspondent-banking.pdf.
[57] IMF (2016), *The Withdrawal of Correspondent Banking Relationships: A Case for Action*, www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf.
[58] Authors' interview (September 2016).
[59] UK National Risk Assessment of Money Laundering and Terrorist Financing (2015), www.gov.uk/government/uploads/system/uploads/attachment_data/file/468210/UK_NRA_October_2015_final_web.pdf.
[60] JMLSG Guidance Part II, 1.36 (2014), www.jmlsg.org.uk/download/9804.

not diminish in the short term, particularly in the absence of clear messaging from international leaders – including through forums such as the G20 that have drawn attention to the issue of derisking. As cited by the Financial Conduct Authority's (FCA) 2016 report *Drivers & Impacts of De-risking*,[61] the Charity Finance Group (CFG) and Charities Aid Foundation (CAF)[62] have warned of an 'avalanche' of derisking affecting smaller institutions. This reaffirms the widely held concern that NGOs, particularly those with certain ethnic and cultural associations, are among groups at greatest risk of account closure as a result of the increased requirements concerning efforts to counter money laundering and terrorist financing placed on providers of financial services.[63]

This perception of risk was underscored in late 2015 by William Shawcross, chairman of the Charity Commission, whose foreword to the commission's report on tackling abuse and mismanagement in charities emphasized that terrorism and extremism represent 'one of the most deadly threats faced by some charities today.[64] With the domestic threat level for terrorism in the UK at 'severe', drawing a link between charities and terrorism is an unwelcome association, leading to both reputational and operational damage for the sector.

Evidence of this damage has been well documented, with high-profile instances of banks such as HSBC, UBS and the Co-operative Bank preventing the transfer of funds, or closing accounts held by UK-registered NGOs. In January 2016, for example, it was reported that HSBC had cut ties with Islamic Relief Worldwide (IRW) the previous year.[65] IRW reported that it had been informed that HSBC 'needed to 'manage the challenge' posed by customers operating in 'high-risk jurisdictions', as a result of an obligation imposed on the bank in a Deferred Prosecution Agreement with the US authorities in 2012 to avoid prosecution for money laundering and dealing with pariah states'.[66]

Increased compliance procedures, such as regular and extended questioning when opening new accounts or sending and receiving funds, are not only applicable to NGO relationships with the banking sector. Transport companies are increasingly seeking indemnities from NGOs in relation to possible dealings with sanctioned and designated entities. Furthermore, NGOs must also fulfil their own due diligence requirements to ensure that they are not used as vehicles for money laundering or terrorist financing, and that their partners and beneficiaries are not sanctioned or designated entities. While this is necessary and correct, NGOs (especially smaller ones) often lack the financial means to accommodate the increased costs entailed. As noted in a 2015 report by the Center for Global Development, even large NPOs, with effective systems in place, often find the costs of compliance prohibitive to their operations, particularly in relation to areas in need of greatest humanitarian assistance where sanctioned or designated organizations are known to operate.[67] The administrative burden and associated costs stretch an already constrained sector, thereby reducing the efficiency and deliverability of aid.

[61] John Howell & Co Ltd for the Financial Conduct Authority (2016), *Drivers and Impacts of Derisking*.
[62] The Charity Finance Group is a UK membership organization that champions finance management best practice in the voluntary sector. The UK-based Charities Aid Foundation supports charities, donors and businesses to make the most of charitable giving.
[63] John Howell & Co Ltd for the Financial Conduct Authority (2016), *Drivers and Impacts of Derisking*.
[64] Charity Commission (2015), *Tackling Abuse and Mismanagement 2014-15 – Full Report*, www.gov.uk/government/publications/tackling-abuse-and-mismanagement-2014-15/tackling-abuse-and-mismanagement-2014-15-full-report.
[65] Ghosh, A. (2016), 'HSBC snaps ties with Islamic Relief over 'terror' fears', *International Business Times*, 4 January 2016, www.ibtimes.co.uk/hsbc-snaps-ties-islamic-relief-over-terror-fears-1535825.
[66] Islamic Relief UK (2016), 'Islamic Relief acts to overcome HSBC setback', www.islamic-relief.org.uk/news/islamic-relief-acts-to-overcome-hsbc-setback/.
[67] Center for Global Development (2015), *Unintended Consequences of Anti-Money Laundering Policies for Poor Countries,* www.cgdev.org/sites/default/files/CGD-WG-Report-Unintended-Consequences-AML-Policies-2015.pdf.

Financial Disruption of Humanitarian Aid

Against this broad domestic and international legislative framework, humanitarian NGOs seeking to operate in sanctioned countries, or in areas where designated NSAGs are based or operate, are faced with considerable and mounting financial challenges.[68]

A 'war of attrition'

NGOs working in such circumstances have complained of 'seemingly endless due diligence and compliance enquiries' from banks, which frustrates and restricts programme delivery. For example, one humanitarian NGO reported having received fewer than 75 banking compliance enquiries per year prior to 2014, whereas in 2015 it received more than 600. NGOs have described the extensive questioning as a 'war of attrition', with little hope of a positive outcome. While it is considered reasonable that NGOs should expect to submit to a heightened level of due diligence, a common feeling is that often the nature and volume of questioning is not proportional to the risks the process is intended to mitigate. Many questions reflect considerable ignorance on the part of the financial institution, such as questions about shareholders or owners that are appropriate for corporate clients but not for NGOs; or appear to be an attempt to wear down the NGO so it goes elsewhere, rather than the bank having to reject its application. For example, one high-profile NGO described having spent almost a year answering questions related to an application to open a basic deposit account (i.e. an account not used to to transfer funds), without any success. The lengthy process of enquiries mean that some aid programmes are delayed, fail to start or have to be heavily scaled back. This was the case, for example, with the transmission of funds for one aid programme supporting some 10,000 people in Syria, which had to close in 2013.

NGOs have also noted a 'widening of the compliance net' as the area of risk perceived by banks expands beyond a specific conflict-affected or sanctioned area. NGOs need not be working directly in Syria, but in a neighbouring country such as government-controlled Iraq or Lebanon,[69] to be met with enhanced due diligence requirements,[70] including additional scrutiny of the source, destination and use of funds prior to transmission, because some of their programmes relate or refer to Syria. For example, one NGO consulted as part of the research for this paper was contacted by a member of its bank's compliance team because the organization's website mentioned its work with Syrian refugees.

Dealing with this enhanced level of scrutiny is time-consuming. The finance director of one NGO reported that it had been necessary to hire two additional members of staff to fulfil the increased compliance and due diligence requirements of its bank's relationship managers and compliance staff. Another described the compliance relationship as 'very intensive', with almost all international payments needing to be pre-approved – i.e. to demonstrate that payment beneficiary names have been screened against sanctions lists – before being formally submitted for transmission. This problem affects programmes not only for areas in which designated NSAGs operate, but also for areas that are, or have been, subject to international sanctions regimes such as those for North Korea or Myanmar.

[68] The NGO experience referenced in this section was gathered at a workshop in September 2016.
[69] Case study provided to authors.
[70] Further details on what enhanced customer due diligence entails can be found in Paragraph 20 of the 'Interpretive Note to Recommendation 10' in *The FATF Recommendations*, www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf, but in essence these include obtaining additional information on sources of funds, reasons for the intended transaction, escalating the transaction to senior management for approval, and applying greater scrutiny to the details of transactions.

NGOs have highlighted the need to consult the sanctions lists of a number of states, as well as screen for adverse media related to beneficiaries, to check that intended payments and transfers are permissible, as adding complexity and time to their processes. This is particularly the case where there are difficulties in precisely identifying beneficiaries arising from commonality in names or a lack of official identity documents. Although there are private suppliers of services for screening multiple lists and monitoring for adverse media stories – i.e. screening news websites and other media outlets for evidence of potential heightened risk such as news of criminal investigations or convictions – use of such services adds further to NGOs' compliance costs. One humanitarian NGO reported spending some £40,000 annually on staff and software costs for screening; another cited costs of up to $250,000 in this area. The credibility of information supplied by private vendors has also been questioned, in that the data used have proved unreliable and yet may have been used to inform important decision-making relating to the accounts of individuals and entities, including NGOs.[71]

By following proper procedure and securing a licence, NGOs are paradoxically presenting banks with a material warning flag that reduces the banks' appetite to process the transaction.

In addition to the heightened scrutiny applied to humanitarian NGOs, banks often display a lack of understanding of the risks faced by NGOs and how they manage these challenges, assessing NGOs as they would a corporate client. Rather than being risk-based, processes may seemingly follow a box-ticking approach: for example, one bank felt it necessary to undertake beneficial ownership due diligence on an NGO's trustee panel, treating trustees as if they were owners or shareholders. Another asked a lengthy series of questions about projects and payees in respect of an account application that was intended only for deposits and not for payments.

Another area in which NGOs consider themselves subject to unreasonable demands is licensing. Several NGOs provided examples of UK banks requiring OFAC licences despite there being no obvious link to the US, such as for euro-denominated transfers. Furthermore, as indicated above, licences can take months to secure, if they are issued at all, and the legal costs involved in obtaining each licence can outweigh the value of the goods to which the application applies. For example, obtaining US approval for a computer destined for Syria may cost three times as much as the computer itself, according to one NGO.[72] To add to this complexity, in some cases where US export bans are in place, licences may be needed not only from OFAC but also from the US Department of Commerce in respect of goods and technology with more than 10 per cent US content value, even for foreign-produced items.[73] Moreover, as confirmed by interviews with both US and UK banks, there is a sense that NGOs that need a licence are by definition 'working at the edge' of legality. Put simply, by following proper procedure and securing a licence, NGOs are paradoxically presenting banks with a material warning flag that reduces the banks' appetite to process transactions.

[71] BBC News (2015), 'Why did HSBC shut down bank accounts?', 28 July 2015, www.bbc.co.uk/news/magazine-3367794.
[72] Walker, J. (2016), *Humanitarian Impact of Syria-Related Unilateral Restrictive Measures*, p. 14.
[73] Ibid.

Increased costs and transfer delays

This increase in bureaucracy related to banking compliance requirements was described by NGOs as ‘occasional’ as recently as three years ago; now, it is ‘constant’, and for most NGOs this has meant hiring extra staff and seeking costly legal advice to deal with banking and licensing issues. In one case, legal advice for setting up a new relief operation was reported as costing as much as £40,000. Another NGO described how the legal advice for an OFAC licence application outweighed the cost of the equipment to which the licence application related. And, as mentioned above, another reported that two full-time staff members had been hired to handle the increase in compliance-related work required to deal with information requests from their banks to support payment requests.

The NGOs interviewed for this paper emphasized that they were not objecting to making such investments, and generally understood why due diligence enhancements are required, accepting that related overheads are a necessary cost of providing humanitarian aid in sanctioned countries or in areas where designated NSAGs are based or operate. However, they felt that their efforts and investments in compliance were not fully appreciated by their bankers, and thus their ability to access financial services remains challenging at best (and deteriorating further at worst), with payments in support of programmes in high-risk environments still frequently delayed for weeks while additional due diligence information is requested by the bank, or otherwise blocked entirely. One NGO reported that a medical programme in Egypt had collapsed as the required funding could not be delivered.

> One NGO assessed that it loses up to £0.5 million pounds a year through lack of access to the most favourable exchange rates, as a result of some financial institutions being unwilling to transact with it.

The restriction, and in some cases loss, of banking access has also led to the use of more expensive (and less transparent) financial channels, such as third-party payment mechanisms via countries neighbouring the conflict- or sanction-affected destinations. When such routes are available, however, this significantly increases funds transfer costs. According to one NGO, its alternative arrangements now cost 12 times more per transaction compared with its previous arrangements for overseas transfers to the same destination. Another humanitarian NGO reported that it was unable to send money to Sudan for four months because no intermediary bank was willing to support transfers. (It eventually found a third-party payment route for the funds via an opaque alternative mechanism.) A further NGO assessed that it loses up to £0.5 million pounds a year through lack of access to the most favourable exchange rates, as a result of some financial institutions being unwilling to transact with it.

Transfer delays are also often reported after certain – often false positive – words and phrases trigger bank transaction monitoring filters, causing banks to block the transfer of funds. Where transactions are rejected and returned by the correspondent bank, an explanation is rarely provided that would enable the NGO to improve on future transaction requests. Furthermore, returned transactions incur charges; and if a foreign exchange conversion has also been involved (for example where a US dollar payment has been made from a sterling account), a loss is almost always also incurred on reversal. One NGO that uses a large money service business to transfer funds to its offices abroad reported having struggled particularly when dealing with Turkey, as one of the NGO’s employees (a Turkish national) has the same name as someone on a sanctions list. This means that each month payments are blocked, and the NGO has to answer the same compliance questions and supply the same documentation to secure the release of funds – a process that was at times taking up to three weeks during 2016. Another NGO described how a payment to Iraq was suspended following a partial match between a word in their payment description and a town under the control of Islamic State of Iraq and Syria (ISIS). After a month's delay and clarification, the transfer arrived successfully.

The reduction of correspondent banking services caused by derisking has added to the challenges faced by humanitarian NGOs, as it significantly affects regions where they operate. This last case had suffered an additional delay of a month after the NGO's bank cut ties with its Iraqi partner NGO's bank. The funds involved had been intended for a cash-based programme for people fleeing the conflict around Mosul. Families eventually received cash assistance some eight weeks later than planned, but were left meanwhile without basic necessities including food and medicine. Furthermore, the level of funding had been based on a detailed needs assessment, but by the time the funds actually arrived the number of people in need had increased significantly. This meant that the distribution of funds could only cover part of the population in need, leading to tension and security issues on the ground. This example demonstrates some of the significant planning challenges posed by uncertain cash flows resulting from derisking. Given the fluidity of the situations in which NGOs may be operating, any delay in funding will undermine the preparation and delivery of such projects.

Closure of accounts

In its compliance toolkit for charity trustees, the Charity Commission notes: 'Good financial stewardship of the charity includes the appropriate use of a bank account, where access to the money is restricted[74] and its movement can be easily traced.' It further emphasizes: 'In order to operate effectively and transparently when delivering aid or undertaking charitable work, every charity needs access to banking facilities.'[75] In the most severe cases, however, UK banks have withdrawn services to NGOs altogether. A number of such incidents have been widely reported in the press.[76] One NGO that monitors human rights in Sudan and Somalia and receives funding from the UK Foreign & Commonwealth Office (FCO) lost its UK high street bank account as a result of what was termed a 'change in risk policy'. As this was the organization's only bank account, it has been unable to implement key programmes or pay staff. Despite several attempts to open a new account, no bank has yet been willing to provide the NGO with services, meaning that assets of more than £200,000 cannot be accessed. This situation – arising through derisking rather than through any wrongdoing on the part of the NGO – has continued even after the NGO obtained a letter from the FCO highlighting the importance of its work and their partnership. The NGO's position is now critical, since it has lost its auditor as a result of not having a bank account, and in the absence of any resolution it may have to close altogether.[77]

[74] Meaning in this context that use of the account is clearly controlled.
[75] Charity Commission for England and Wales (2011), *Compliance toolkit: Protecting charities from harm – Chapter 4: Holding, moving and receiving funds safely in the UK and internationally,* www.gov.uk/government/uploads/system/uploads/attachment_data/file/571771/Chapter_4_new.pdf.
[76] See for example HSBC's decision to close the accounts of Finsbury Park Mosque, Ummah Welfare Trust and the Cordoba Foundation, www.rt.com/uk/176652-gaza-hsbc-charity-scandal/; UBS' account closure of Islamic Relief, www.civilsociety.co.uk/news/banking-sector-nerves-blocking-international-relief--says-islamic-relief-fd.html; and the Co-operative Bank's closure of the Palestinian NGO Friends of Al-Aqsa, www.independent.co.uk/news/business/news/co-op-bank-shuts-down-account-belonging-to-palestinian-charity-friends-of-al-aqsa-without-a6798576.html.
[77] Case study provided to the authors.

Relationship between banks and NGOs

Interviews conducted as part of the research for this paper suggest that the nature of the relationship between NGOs and banks varies, and is often dependent on senior leadership by individuals within NGOs and banks and the extent to which genuine efforts are made to understand each other. Where banks do recognize the importance of providing accounts and financial services for NGOs, there is genuine engagement and a willingness to invest time in understanding the NGO business model, assessing risks and learning about the mitigation steps taken by each NGO. One NGO also reported that a high-street bank had offered welcome assistance with the risk assessment of a planned cash programme. The considerable discrepancy between institutions within the financial sector as regards their understanding of NGOs is reflected in the due diligence process they require. Banks that are willing – or willing in principle – to provide NGO banking services appear to ask more reasonable and relevant questions, approaching their due diligence in a more sympathetic and understanding manner. In contrast, others display very limited awareness of the way the sector operates, and thus engage in extensive but ill-informed questioning with very likely negative results, particularly for smaller NGOs that have fewer legal and finance staff or less compliance-related expertise.

Many NGOs make considerable investments, in terms of resources, expertise and time, in building their banking relationships. Some, however, do not, appearing to expect financial services to be provided as a utility, taking the due diligence questions they are asked as an affront, and making little effort to build relationships and educate banks as to their activities. The regulatory and legislative framework with which banks must themselves comply requires them to perform due diligence (so-called 'Know Your Customer' procedures) on their client base. The lengthy questionnaires and interviews with which NGOs are presented are inevitably daunting and time-consuming, and very often are ill-designed for the NGO sector. Those NGOs that do comply with the information and diligence requests from banks broadly feel that these efforts are rarely rewarded, and find that financial access continues to be ever more restrictive.

Donors

A further area of concern revealed during the research for this paper is the nature of the engagement of both government and private-sector donors with the banking issue. Donors, and particularly government agencies such as DFID, are often accused of unfairly leaving the responsibility for the due diligence required for funds transfers with humanitarian NGOs working in conflict zones, and of doing little to assist with the compliance and administrative issues that NGOs face in dealing with their banks. In some cases, donors demonstrate a lack of knowledge as to how programmes are implemented – for example, providing payment in euros for NGO staff in Syria who need US dollars to meet their spending requirements, meaning that the NGO then has to conduct foreign exchange transactions (i.e. selling the euros received to buy the US dollars required) and thereby incurs avoidable costs and an additional set of due diligence obligations.

Furthermore, donors do not appear fully to acknowledge the incremental administrative and compliance costs borne by NGOs in recent years as a result of bank requirements. In one case, the example was cited that DFID had traditionally allocated 7 per cent of grants to meet administration costs, but this is now insufficient to cover the time and expense of meeting bank compliance requirements. However, NGOs submitting funding bids are reportedly often unwilling to state explicitly to donors what the genuine cost of compliance is, because they fear that this may lead to fewer bids being funded as their budgets appear less competitive and thus offering less value for the donor's money. If donors, particularly governments and multilateral agencies, were to become more actively involved with this issue, for example by engaging directly with the banking sector to explain their donor programmes, they may be able to mitigate some of the spiralling compliance costs and alleviate the burden for those NGOs entrusted with aid delivery.

Lack of HMG coordination and engagement

Throughout the interviews conducted for this paper, a lack of cross-government coordination and genuine engagement with the NGO sector were cited as major impediments to mitigating the challenges posed by increasing financial restrictions. Since the Independent Reviewer of Terrorism Legislation recommended in 2014 that a dialogue be initiated between NGOs and policymakers, there has been some limited engagement in the form of ad hoc meetings and contacts between NGOs and Whitehall, including intermittent overtures from Treasury ministers, and the publication of a 'for information note' by the Home Office and HM Treasury addressing frequently asked questions, raised by a group of NGOs, related to operating within counterterrorism legislation.[78] In addition, in its role as co-lead of the FATF's work on the revision of Recommendation 8, the Charity Commission convened several cross-sectoral gatherings to solicit views from the NGO sector. But these initiatives have gathered little overall momentum, and limited attempts have been made to address financial restrictions deferring to the 'individual commercial decisions of financial institutions'.[79] For example, on the question of withdrawal of financial services, the government's 'for information note' merely draws attention to the derisking statement published by the FCA. Formal engagement via the establishment of the promised working group also remains absent.

> Clear tension exists between maintaining tight compliance with sanctions and designation regimes, and delivering aid to fragile and broken states. Until the government determines which of these objectives to prioritize, NGOs will continue to suffer.

At its heart, this lack of coordination is evidenced by the conflicting positions of DFID and HM Treasury. Clear tension exists between maintaining tight compliance with sanctions and designation regimes, and delivering aid to fragile and broken states. Until the government determines how to balance these objectives, NGOs will continue to suffer as a result of the banking restrictions that prevent them from meeting donors' (including DFID) objectives.

Conclusions

Over the past few years, NGOs have faced ever increasing restrictions on their financial activities, at best facing an increasing compliance burden and transaction delays resulting in programme disruptions; at worst payment failures and bank account closures. The conflict between the regulatory and legislative pressures on banks as relates to financial crime compliance, particularly

[78] Home Office and HM Treasury Office of Financial Sanctions Implementation (2016), 'Guidance for information note: operating within counter-terrorism legislation'.
[79] CAGE (2014), 'CAGE banking saga: Her Majesty's Treasury writes to CAGE', CAGE blog, 4 April 2014, http://cage.ngo/uncategorized/cage-banking-saga-her-majestys-treasury-writes-cage/.

counterterrorism finance, and the desire of donors and NGOs to deliver aid to people in areas where designated NSAGs are based or operate seems intractable.

Despite assertions by HM Treasury and other government departments that they are seeking to address bank derisking from both a policy and a supervisory perspective, the amendment to FATF's Recommendation 8, together with joint initiatives such as the British Bankers' Association, Disasters Emergency Committee and Freshfields 2013 guidance paper *Getting Aid to Syria*,[80] banking/NGO engagement meetings on payments to Gaza in 2014, and the considerable investments made by many NGOs in compliance staff and procedures, the trend of financial restriction continues. NGOs feel, moreover, that their ability to access financial services remains challenging at best and deteriorating at worst. This is a complex and multifaceted issue, but unless all parties are agreed on the overall objective, then restrictions will continue to mount. Thus, by way of conclusion, this paper offers a set of recommendations from a UK perspective.

The UK government needs to facilitate a more balanced outcome between the competing objectives of delivery of aid to broken and fragile states and the certainty of non-diversion; and this will require the government to provide guidance on prioritization. In the absence of case law, it should also provide guidance on the reasonable steps that humanitarian NGOs are expected to take when active in areas where designated NSAGs are based or operate, and should consider publicizing cases where unwitting diversion has occurred and no enforcement action has been taken.

NGOs need to engage (if they are not already doing so) with their banks to demonstrate the extent to which they have raised their operating standards in recognition of the risk environment in which they operate. NGOs should also build relationships and educate their banks on the nature of their humanitarian programmes, and on the measures they take to identify and mitigate risks related to aid diversion, particularly when operating in areas exposed to NSAGs. NGOs should also systematically collect and aggregate the costs, incidences and impact of financial restrictions on their activities.

Banks need to develop specialist knowledge to better equip them to understand the NGO sector, rather than treat NGOs as a subset of their corporate client base. Furthermore, as advocated by the FCA, banks need to be willing to apply a risk-based approach to banking NGOs, recognizing the important role that they play – and that they cannot fulfil this role without access to financial services.

The Charity Commission should form a banking working group that facilitates learning and assists banks to develop due diligence procedures that are relevant for the NGO sector.

Critically, the UK government must take leadership and ownership of the challenges identified in this paper. It needs to demonstrate commitment to the notion that the UK will use its formidable development budget and soft power to promote 'British values',[81] and to tackle the causes of security threats, not just their consequences. It needs to provide clear guidance, support and consistent messaging on the use of licences when called for, and consider the introduction of humanitarian exemptions from counterterrorism laws that provide legal certainty for NGOs and their bankers, thereby removing the ambiguity, complexity and inefficiency of licensing. Moreover, it should publicly endorse the work of NGOs, providing strong and committed messaging that the delivery of aid is

[80] British Bankers' Association, Disasters Emergency Committee and Freshfields Bruckhaus Deringer LLP (2013), *Getting aid to Syria: Sanctions issues for banks and humanitarian agencies,* http://fatfplatform.org/wp-content/uploads/2015/03/Getting_aid_to_Syria.pdf.
[81] According to the UK's 2015 National Security Strategy and Strategic Defence and Security Review, 'Democracy, the rule of law, open, accountable governments and institutions, human rights, freedom of speech, property rights and equality of opportunity, including the empowerment of women and girls, are the building blocks of successful societies.' *National Security Strategy and Strategic Defence and Security Review 2015*, p. 10.

a key government priority that the banking sector should support, despite the risks of diversion. Although engagement between government and NGOs does take place on an ad hoc basis, the promised establishment of the formal working group is overdue, and this should be constituted as a priority. The government should also take the lead in engaging with other key regulatory jurisdictions, particularly the US, to ensure that the current extraterritorial regulatory threat is addressed.

Without this leadership, the UK government's development objectives are at risk of failure, as loss of financial services further restricts the activity of NGOs at a time when their activities are certainly more critical than ever before.

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About the Chatham House Humanitarian Engagement with Non-state Armed Groups project

Chatham House has undertaken a study of certain factors that contribute to facilitating engagement with non-state armed groups (NSAGs) for humanitarian purposes. The initiative is intended to generate both political support and practical policy options in order to increase the effectiveness of humanitarian action in areas of conflict through improving engagement and interaction with NSAGs.

This paper is one in a series of three that consider different aspects of the regulatory framework relevant to humanitarian action and NSAGs:

- *Humanitarian Action and Non-state Armed Groups: The International Legal Framework*
- *Humanitarian Action and Non-state Armed Groups: The UK Regulatory Environment*
- *Humanitarian Action and Non-state Armed Groups: The Impact of UK Banking Restrictions on NGOs*

In 2016 Chatham House published a series of five papers as part of this study.

- *Towards a Principled Approach to Engagement with Non-state Armed Groups for Humanitarian Purposes*, Michael Keating and Patricia Lewis
- *Engaging Non-state Armed Groups for Humanitarian Purposes: Experience, Constraints and Ways Forward*, Andrew MacLeod
- *Engaging Armed Actors in Conflict Mediation: Consolidating Government and Non-governmental Approaches*, Claudia Hofmann
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