GLOBAL NPO COALITION ON FATF SUBMISSION FOR PHASE II OF THE UNINTENDED CONSEQUENCES (UIC) WORKSTREAM: MITIGATING MEASURES FOR DE-RISKING AND FINANCIAL EXCLUSION OF NPOS

1. The Global NPO Coalition on FATF's earlier submission to the UIC project team laid out the scale and scope of the financial access problems facing NPOs, referencing the vast empirical evidence on de-risking gathered worldwide over the past few years.

2. The FATF needs to recognize that de-risking is undermining the very goals of the FATF Standards by moving money into less transparent channels (such as cash carry, unlicensed hawalas, etc.). This increases TF risk and decreases the effectiveness of the financial integrity standards.

3. A recent World Bank study of 107 FATF Mutual Evaluation Reports (4th Round)[1] found that assessors do not see financial exclusion as an ML/TF risk if the rate of exclusion in the economy is less than 30%. The informal economy was cited as a risk more frequently in assessments than financial exclusion, leading to there being no recommendations in the MERs to address the issue.

4. The **regional effects are overwhelming**. For example, a recent study carried out by the Global NPO Coalition in partnership with NPOs from 17 Latin American countries showed that '…approximately half of the NPOs surveyed are aware of cases of financial exclusion of NPOs – denial of financial services or excessive and onerous delays in banking procedures – and half of them consider that the situation has worsened in the context of the COVID-19 pandemic. In several countries, the problem of lack of access to financial institutions is serious and NPOs do not perceive that countries are promoting solutions.' In Syria, Damascus based international NGOs (INGOs) report that, as of April this year, banking challenges threaten relief for 1.2 million Syrians,[2] with 62% of Damascus based INGOs continuing to face difficulty receiving funding in Syria, 12% of transactions being rejected outright, 32% of INGOs facing delays of transfers of 3–10 months, something that is incompatible with the urgency of humanitarian programming in Syria. INGOs identified that the majority of the blockages were coming from intermediary banks.

5. The FATF has issued guidance over the years on financial inclusion and correspondent banking, attempting to clarify the international Standards to avoid misunderstandings that could contribute to de-risking. This has, however, not been successful in tackling the problem. At the present moment, NPOs facing financial access difficulties have no recourse to remedy. **Solutions need to move upstream, and this means changes to the FATF Standards, procedures and methodology**.

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[1] Not yet published: the authors had access to the salient findings of the report, which is due out shortly.

[2] Private Briefing Note: Understanding the operational impacts of sanctions on Syria II: Damascus based INGOs and Bank derisking

6. Crucial to this is a **change in the FATF evaluation methodology** to penalize overregulation which leads to overcompliance by financial institutions, which then leads to de-risking. The FATF Mutual Evaluation methodology should, for example, include a **specific outcome for NPOs under Immediate Outcome 10**, which would look not only at overregulation (the non-risk-based and overzealous compliance with AML/CFT laws and regulations) but also at financial exclusion due to overcompliance by financial institutions and correspondent banks leading to the wholesale, and not risk-based, de-risking of NPOs. This will **ensure that the effectiveness ratings in an assessment capture de-risking**.

7. **Financial access for NPOs needs to be incentivized**. The existing FATF narrative currently prioritizes financial integrity at all costs. This can be achieved by enhancing, through the FATF's methodology and processes, the willingness and capacity of jurisdictions to advance inclusive financial integrity. Fundamental to this is an acknowledgement by the FATF (in its Recommendations, guidance, speeches), its members, the FSRBs, the FSRB members, financial supervisors, and the private sector that financial inclusion is key to achieving financial integrity.

8. Financial access can also be incentivized by **amending the FATF Standards to rethink current compliance practice**. The same World Bank research referenced earlier showed that, somewhat counter-intuitively, high income countries tend to use exemptions and simplified due diligence (SDD) more than middle or low income ones. Supervisory authorities in middle and low income countries tend to have lower capacities and hence lack the flexibility needed to calibrate rules for SDD, leaving this to the private sector, the research demonstrated, who were then understandably reluctant to take any risk. As a recent RUSI report outlined, the FATF needs to **amend Recommendation 1** to balance the language between the optional use of SDD and the mandatory use of enhanced due diligence (EDD). The World Bank research showed that the use of SDD was criticized in many MERs. **The FATF should make it clear in its Standards and guidance that the use of risk-based SDD is judicious and efficient**, and helps contribute to inclusive financial integrity. The RUSI report also calls for changes to additional Recommendations, which the Global NPO Coalition endorses. One is to **Recommendation 2** (National cooperation and coordination), where the need for financial inclusion and financial crime policies to be mutually reinforcing should be explicitly stated (and assessed). The other is to the **Interpretive Note of Recommendation 10** (customer due diligence), which mentions 'remote verification' as an example of higher risk – this blanket requirement should also be amended to ensure it is risk-based.

9. Amendments to the Recommendations, methodology and procedures thus need to mirror a **carrot and stick approach**: while incentivizing financial access for NPOs with SDD where appropriate, they also need to set out sanctions for jurisdictions that misapply the Standards, leading to overcompliance and overregulation.

10. **Robust sectoral Risk Assessments**, part of the FATF risk-based approach, are key to effective oversight of the NPO sector, as well as to ensuring that the sector is not subject to unintended consequences stemming from the implementation of FATF Standards in country. Currently, not many countries have carried out a proper sectoral TF Risk Assessment, with

the sustained involvement of the sector, taking into consideration already-existing laws/regulations and sectoral self-regulation measures. Evidence shows that NPOs in country do not have sufficient information on whether there is a particular segment of the sector which is at higher risk of being abused for TF, or even whether activities involving TF vulnerabilities have been identified. At the same time, evidence shows that NPOs have relevant information on measures taken by the sector to mitigate risks of abuse for TF – due diligence practices and self-regulatory systems, for example – which have not been shared with their respective national authorities. This lack of research, evidence, and engagement does not help achieve a shared understanding of the risks faced by NPOs. A **robust Risk Assessment is likely to also lend comfort to banks**, who can then focus EDD efforts, if needed, on the subset of NPOs flagged as potentially being at higher risk of TF abuse. FATF and FSRB jurisdictions should be trained on NPO sectoral Risk Assessments, and assessors trained on and sensitized to the topic.

11. The FATF can take a leaf out of EU's book/approach. The **European Banking Authority**, on the basis of evidence it gathered recently,
    a. observes that **de-risking is a continuing trend** that has implications from an ML/TF risk, consumer protection and financial stability point of view
    b. has revised its ML/TF Risk Factors Guidelines, which clarify that the application of a risk-based approach to AML/CFT does not require financial institutions to refuse, or terminate, business relationships with entire categories of customers that are considered to present higher ML/TF risk
    c. has launched a public consultation on changes to its existing Guidelines on risk-based AML/CFT supervision. The proposed Guidelines require competent authorities to take stock of the extent of de-risking in their jurisdiction and **address de-risking in their ML/TF risk assessments**.
    d. The European Commission's DG FISMA issued a Guidance Note On the Provision of Humanitarian Aid to Fight the Covid-19 Pandemic in Certain Environments Subject to EU Restrictive Measures which clearly specifies that EU sanctions are not meant to stand in the way nor impede the supply of humanitarian aid. Any action not explicitly prohibited under EU sanctions is considered permitted, unless otherwise stated by a national competent authority (NCA). It stresses that over-compliance should not lead to undermining the provision of humanitarian aid.

Additionally, the EU has appointed an EU-level contact point for humanitarian aid in environments subject to EU sanctions, clearly acknowledging de-risking as an issue.

12. The FATF should publish further guidance for financial supervisors mandating **supervisors** (supranational and national) **to monitor and report on institutional decisions to use EDD in lower risk scenarios**. NPO financial exclusion (not just access but usage) should be measured, and guidance to FIs should be clear. This is essential if the current 'zero risk' culture is to be addressed. This Dutch Central Bank note is an example of supervisory guidance on customer due diligence which does not mention the revised Recommendation 8 – common across other such guidance documents seen.
The European Central Bank, for example, has published its expectations on how banks should

manage climate and environmental risks in their balance sheets. Central Bank supervisors are beginning to make choices which align with worldwide developments such as climate change and sustainability for peoples' prosperity and wellbeing. Increasing humanitarian need, accelerated by COVID-19, demands the swift transfer of money to reach the most vulnerable – currently hampered by bank de-risking.

13. In the absence of FATF action, guidance by FATF members has had limited impact in the COVID-19 response where statements and guidance notes have not resulted in a let-up in bank de-risking issues. Despite the calls from OFAC and the EU for banks to facilitate transfers to support the COVID-19 response, we have not seen any increased flexibility from the banking sector. While recent guidance notes on the part of governments and regional bodies are welcome, they have so far failed in ensuring a consistent and reliable channel for humanitarian organisations to access financial services in fragile contexts

14. The **Alliance for Financial Inclusion and CENFRI toolkit** on Inclusive Financial Integrity seeks to align 'financial inclusion and AML-CFT outcomes with respect to the formulation and implementation of related policy and regulation', and emphasizes that NPOs 'are vital for the organizational capacity, capacity building and empowerment of FDPs [forcibly displaced persons], women, MSMEs and other vulnerable groups. However, they are adversely affected by AML-CFT frameworks that are not inclusive and have been on the end of unjustified de-risking. Countries should consider including NPOs as target groups in their financial inclusion agendas and should explicitly link this to the financial integrity strategy'. NPOs have played a critical role during the COVID-19 pandemic, and financial access for NPOs 'should be supported and strengthened', the toolkit states.

15. A **formal recognition of the problem and role of disinformation in de-risking** and a call for states to proactively combat disinformation about NPOs, particularly disinformation that seeks to tie NPOs to allegations of terrorism. What is not commonly recognized is the increase in politically-motivated disinformation manufactured in an attempt to discredit or delegitimize NPOs through accusations of associations with terrorism (see here and here for more). It is important to triangulate negative information found about NPOs, even if the information appears to come from "credible" open sources, or to seek out contrary information on the same NPOs.

16. **Training**: training of assessors to look for and recognize financial exclusion. Evaluators need to be able to look into the potential de-risking attitudes of banks as part of the FATF's effectiveness component in its methodology. And specific training on FATF Standards to sensitize jurisdictions on the risk-based implementation of Recommendation 8, and on issues NPOs are faced with in regard to the AML/CFT framework and its in-country implementation. As the Global Coalition, we have been engaging intermittently with the training team at the Secretariat, but would like to see a more sustained engagement in terms of possible co-creation of an NPO module for both assessors and the Standards training. This applies to both financial inclusion/de-risking as well as the undue targeting of NPOs through non-implementation of the FATF's risk-based approach and the curtailment of human rights. Many states are signed up to the International Covenant on Civil and Political Rights (ICCPR)

and follow the norms set out by International Humanitarian Law, International Human Rights Law and International Refugee Law. How these intersect and interfere with (misapplied) financial integrity Standards could be parsed in the training.

17. The culture change needed to solve the problem of de-risking of NPOs will only come about if this **change is wired into the financial integrity Standards** of the FATF. This includes **3 main** things:

    a. monitoring and mitigation of de-risking and financial exclusion behaviour in and through the assessments (amendments to methodology and procedures)
    b. changes to the relevant FATF Recommendations and Immediate Outcomes to address NPO de-risking
    c. sanctions for jurisdictions that misapply the Standards and incentives for those that apply the (revised) Standards

18. Cross-border transfers to NPOs have been severely hampered by the **overall decline in correspondent banking** in the last decade, affecting some jurisdictions and regions more than others. ML/TF risk and risk mitigation drives overall risk appetite and profitability, and is one of the major factors propelling this decline. Again, **assessors need to look for, recognize, and report the impact of this phenomenon on financial inclusion**, including the financial access of NPOs.

19. **Even where main banks are willing to provide transfers, it is often the intermediary or corresponding banks who are unwilling to complete transfers.** De-risking arises with both main banks, with whom NPOs have long standing relationships, and with correspondent banks, with whom NPOs do not have relationships. Correspondent banks can normally only see the payment request itself, without information around all the risk management that the client has put in place before the transaction reaches the correspondent bank. If a correspondent bank is risk averse, there is no incentive to support and investigate further and they can simply reject the transaction, with no warning or explanation.

20. The **primacy of the US dollar in cross-border financial transactions** means that financial supervisory and regulatory authorities in the US have an oversized impact on global money flows. Assessments need to pick up on these financial bottlenecks and the FATF membership then needs to work with the relevant stakeholders (including multilateral ones such as the G20, FSB, CPMI) to amend guidance and help mitigate the issue at source. Failure to comply with OFAC regulations could have major reputational and operational consequences for banks, including the withdrawal of US banking licenses. This was reflected in the introduction of the Ceasar Act, recently introduced US sanctions focused on Syria, which sparked a new wave of de-risking, with some European banks telling NPOs that they will no longer provide transfers to Syria owing to these sanctions. **FATF should prioritize engagement with OFAC** to address these issues.

21. We realise that the FATF alone cannot solve the problem, which is why we also engage in multi-stakeholder dialogue in country and internationally, and recognize that bodies such as

the G20, the GPFI and the FSB also need to play their role.

22. **Impact assessments**: while the Strategic Review and Unintended Consequences workstream are a form of *post-hoc* impact assessment after four rounds of FATF evaluations, what is critically needed is *ex-ante* impact assessments of the FATF Standards, methodology and procedures, including of the quality and appropriateness of the FATF's training modules and, most importantly, the appropriateness of the FATF framework for the different regions (FSRBs) and countries. This could be combined with a mid-term review halfway through the Mutual Evaluation cycle for lessons learnt in terms of effectiveness and efficiency. One could consider National Risk Assessments as a form of impact assessment. However, the FATF does not provide guidelines for conducting National Risk Assessments and could consider developing guidance based on impact evaluation methodologies, which may help detect unintended consequences from the very start of a Mutual Evaluation process. Country-level impact assessments, linked to the ongoing National/Sectoral Risk Assessment cycles, will similarly help decide which (revised) Standards would need to be applied and to what measure.

23. **De-risking of NPOs is costing lives** – a recent UN (Office for the Coordination of Humanitarian Affairs) OCHA report estimated that 235 million people need humanitarian assistance and protection. This number has risen to 1 in 33 people worldwide – a significant increase from 1 in 45 in 2020, and rising still. And de-risking of NPOs is hindering this flow of much-needed humanitarian assistance. The FATF has a chance to address the issue now through this workstream as well as the ongoing Strategic Review, to ensure that its Standards stay relevant and focussed, and are effective in delivering its mandate of fighting financial crime.