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Addressing roadblocks to cross-border giving

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The important fight against AML/CFT should not come at too high a cost for civil society.

Civil society has historically existed and collaborated on an international level. It provides major hubs and platforms for cross-border giving, enabling all kinds of acts of solidarity across the globe. The significance and importance of this ability to act across borders has become more apparent than ever during the Covid-19 pandemic, as societies and communities around the world have found themselves in need of support or in a position to offer it to others.

A range of intermediaries currently exist to facilitate cross-border giving for individuals and for-profit/non-profit organisations. The

Charities Aid Foundation (CAF), a UK registered charity and one of Europe's largest foundations, is one of them. In the 2019/2020 financial year over £700 million has been granted by the CAF Group into over 100 countries.¹ CAF helped donors with their giving to the Covid-19 Solidarity Response Fund for the World Health Organisation, and enabled tax-effective giving to other European countries through membership of Transnational Giving Europe²³, while other individual members of the network also transfer much larger sums to beneficiaries abroad outside of the network.⁴

In order to make safe and effective cross-border giving possible, CAF (and other intermediaries) clearly need to operate within the rules governing global financial systems - including complying with Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) regulations and sanctions regimes⁵. Often this means not only being aware of the regulatory environments within

¹ The CAF Group is a major provider of financial services to non-profits and offers a range of products and services that help donors with their charitable giving.

More information at: <https://www.cafonline.org/>

² The Maecenata Foundation is the German member of the network. More information at:

<https://www.transnationalgiving.eu/>;

³ Giving facilitated through the network partners

increased from €13.8 (2019) to €28m (2020)

⁴ More information at:

<https://www.cafonline.org/home/who-foundation>

⁵ Rupert G. Strachwitz (2021): Why do philanthropists need to worry about AML/CFT? Online:

<https://www.philanthropyadvocacy.eu/news/why-do-philanthropists-need-to-worry-about-amlcft/>

specific jurisdictions, but also those that apply at a supranational level (which play an increasingly important role in global financial systems). The UK's money laundering laws, for example, were revised in 2017 to comply with the European Union's 4th Anti-Money Laundering Directive (AMLD)⁶, and the 5th Directive has been also transposed.^{7 8}

Intermediaries have, over the years, invested considerably in compliance, validation processes and Know Your Customer (KYC) teams. But the requirements for due diligence are both increasing and increasingly costly. Organisations like CAF have to be vigilant and check their donors and their donations regularly. They do this by having robust AML processes in place and working with customers to follow guidelines set down by respected industry bodies like the UK Joint Money Laundering Steering Group. These guidelines lay out expectations on those processing funds; for instance confirming the identity of anyone who donates funds via their organisations and platforms,

verifying sources of funding and wealth, and monitoring transactions regularly. Those processing funds must also carry out verification checks to ensure that recipients are legitimate. This is often the most important reason clients choose to work with intermediaries such as CAF, because it means they can be sure their donation will be put to good use.

AML and CFT regulation can represent a potential roadblock to cross-border giving

AML and CFT regulations, whilst clearly important, can present unnecessary barriers to cross-border giving. In some cases this is deliberate: in the recent past, for instance, some governments have used international recommended standards - such as Financial Action Task Force (FATF) Recommendations - as a reference point for restricting civic space, as well as the flow of philanthropic funds and donations within and between countries, when designing and implementing national law.⁹ But in many cases barriers to cross-border giving arise as unintended conse-

⁶ Government of the United Kingdom / HM Treasury (2017): Consultation outcome - Money Laundering Regulations 2017. Online: <https://www.gov.uk/government/consultations/money-laundering-regulations-2017>

⁷ Government of the United Kingdom / HM Treasury (2019): Consultation outcome - Transposition of the Fifth Money Laundering Directive. Online:

<https://www.gov.uk/government/consultations/transposition-of-the-fifth-money-laundering-directive>

⁸ UK regulated charitable trusts have been excluded from the Trust Registration Service as they have been recognised as low risk for money laundering and terrorist financing; but in some cases and depending on their activities some charities (which includes trusts and foundations as many of them are registered charities) can also come into the scope of the regulation as 'obliged entities'. See: Forsters (2020): Government response to the EU 5th Money Laundering Directive and Trust Registration Service consultation welcomed. Online:

<https://www.forsters.co.uk/news/blog/government-response-eu-5th-money-laundering-directive-and-trust-registration-service>; Philanthropy Advocacy (2020):

Legal Environment for Philanthropy in Europe. United Kingdom - Focus on England & Wales. Country profile. Online: https://www.philanthropyadvocacy.eu/wp-content/uploads/2021/02/UnitedKingdom_2020LegalEnvironmentPhilanthropy.pdf

⁹ Turkey for example introduced in December 2020 the 'Law on the Prevention on Financing of Proliferation of Weapons of Mass Destruction, No. 7262' which is intended 'to ensure full compliance with United Nations Security Council (UNSC) resolutions and related FATF Recommendations, strengthening legal and institutional capacity in combating terrorism financing and money laundering'. The new law also states that procedures and principles around receiving and making donations should be covered in a bylaw. Legal experts and civil society actors have argued that the new law exceeds FATF requirements and imposes restrictions on civic space. See: TUSEV (2021): An analysis of the application of Financial Action Task Force Recommendations and its implications on civil society in Turkey. Online: https://www.tusev.org.tr/usrfiles/images/MaliEylemGorevGucuSivilToplumEN_26022021.pdf

quences of administrative requirements or risk allocation between different parties.

In order to comply with AML/CFT regulation when processing charitable funds and donations, intermediaries require specific sets of information. But a lack of consistency in the application of regulations and the information available across different jurisdictions makes it difficult to meet regulatory requirements when enabling giving and grant-making cross-border, thus increasing complexity and administrative costs.

As an example, the due diligence process for cross-border payments requires that an intermediary establishes 'beneficial ownership' (i.e. who is in control of the receiving entity) and also provides risk profiles of the final recipients of funds. This becomes a very complex process when regulatory compliance across multiple jurisdictions is required, and where it becomes necessary to have full knowledge of any further links of recipients that could pose AML or CFT risks.

Additional complexity arises when states require different sets of information from non-profits and companies in order to comply with national regulation, and furthermore may record this information and make it available to third parties in different ways. Information from official registers and databases is often not compatible or comparable across countries, and sometimes the accuracy of listings cannot be guaranteed

across regulators even in the same country—this makes validation even more challenging.

This not only results in increases to the direct cost of compliance but also makes it far more difficult to rely on due diligence done by other organisations, as they have to deal with similar challenges. Cross-checking information provided by others is more costly – but is needed when it reduces liability which could come with even higher costs (e.g. fines or reputational risks). In many jurisdictions, validation processes (i.e. checking the credentials of receiving entities and ensuring they are legitimate) are outsourced to the mainstream financial services sector. This can represent another potential barrier to cross-border giving because interpretations of risk can be inconsistent across providers, or the understanding of the specific context in which non-profits operate (and how they operate) is low. This means that verification processes are not verifiable by a granting organisation that sits in a different country. At the same time, that organisation remains liable and can be seen as non-compliant if information obtained through external verification processes does not satisfy standards set by national regulators.

De-risking can restrict and undermine the transparency of cross-border giving

Many non-profits are also affected by bank de-risking.¹⁰ Charitable organisations that can not open bank accounts are often turned down on application, leaving no public track

¹⁰ See for example: World Bank (2016): De-risking in the Financial Sector. Online: <https://www.worldbank.org/en/topic/financialsector/brief/de-risking-in-the-financial-sector>; David Artingstall, Nick Dove, John Howell, Michael Levi (2016): Drivers & Impacts of Derisking. A study of representative views and data in the UK, by John Howell & Co. Ltd. for the Financial Conduct Authority. Online: [\[impacts-of-derisking.pdf\]\(#\); Tracey Durner and Liat Shetret \(2015\): Understanding bank de-risking and its effects on financial inclusion. An exploratory study. Global Center on Cooperative Security and Oxfam. Online: \[https://www-cdn.oxfam.org/s3fs-public/file_attachments/rr-bank-de-risking-181115-en_0.pdf\]\(https://www-cdn.oxfam.org/s3fs-public/file_attachments/rr-bank-de-risking-181115-en_0.pdf\)](https://www.fca.org.uk/publication/research/drivers-</p></div><div data-bbox=)

record of the exact reason as to why the decision was taken in the first place. The lack of record about when/why this happens makes it difficult to understand trends or make suitable improvements within the civil society sector. And it also creates a feedback loop, as denial of service by one financial services provider becomes the basis for further suspicion about the applicant's activities and thus future refusals. In the context of cross-border giving this is a major factor, as non-profits that have been excluded from mainstream financial services are very unlikely to undergo verification processes successfully, thereby also reducing their ability to receive foreign donations. The European Banking Authority has recognised these wider phenomena. It notes that 'de-risking continues to pose ML/TF risks, because customers affected by de-risking may resort to alternative payment channels in the EU and elsewhere to meet their financial needs. As a result, transactions may no longer be monitored, making the detection and reporting of suspicious transactions and, ultimately, the prevention of ML/TF more difficult.'¹¹ ¹² The Financial Action Task Force (FATF) will also systematically examine four unintended consequences (including de-risking and financial exclusion) resulting from an incorrect imple-

mentation of the FATF Standards.¹³

Looking towards solutions

Due diligence and compliance is essential, but the wider shift of risk for a very complex regulatory area towards civil society is likely to have a chilling effect on the ability of civil society organisations (CSOs) and intermediaries to process philanthropic funds and cross-border giving. There is a wider need to keep regulatory requirements proportionate and allocate risk in a way that does not deter CSOs and individuals from giving and acting across borders.

Civil society also needs more guidance and affordable or free resources, like helplines and legal advice on-demand, to understand how to meet requirements. Smaller non-profits, in particular, often have to follow strict regulations with very little capacity and guidance about how to properly comply.

There is also a broader lack of understanding across the financial services sector about how civil society organisations operate. More guidance specific to non-profits is definitely required. There is also a wider need for an exchange of best practice and shared standards for due diligence processes.¹⁴

¹¹ European Banking Authority (2021): Opinion of the European Banking Authority on the risks of money laundering and terrorist financing affecting the European Union's financial sector. Online: https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Opinions/2021/963685/Opinion%20on%20MLTF%20risks.pdf

¹² Proposed changes to EBA guidelines on risk-based AML/CFT supervision would require 'competent authorities to pay particular attention to the way financial institutions manage ML/TF risks and encourage them to engage with their sectors to ensure that financial institutions have a good understanding of the regulatory expectations of how ML/TF risks should be managed.' See: European Banking Authority (2021): The EBA takes steps to address 'de-risking' practices.

Online: <https://www.eba.europa.eu/eba-takes-steps-address-%E2%80%98de-risking%E2%80%99-practices>

¹³ Financial Action Task Force (2021): Mitigating the Unintended Consequences of the FATF Standards.

Online: <https://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html>

¹⁴ A recent study by VENRO (the umbrella organisation of development and humanitarian non-governmental organisations in Germany) looked into measures to mitigate the risk of terrorist financing in the non-profit sector in Germany. It recommends (among other measures) 'further government support for the development and exchange of good practice within the NPO sector' as well as 'multi-stakeholder dialogue with

Furthermore, having centralised, easily accessible and verified information available at a national level would remove administrative burdens; freeing time and resources for intermediaries that process philanthropic funds to focus on making informed judgments that ensure cross-border giving can happen safely and effectively.¹⁵ Civil society is already providing solutions in areas where centralised information is not easily accessible. CAF Southern Africa for example has recently launched its new '[Validate4Good](#)' platform which helps local CSOs to be compliant, meet donor requirements and provides a broader resource of information for international and national givers and funders.

Governments could also do more to limit the risks for civil society. They could support specialist entities to undertake due diligence globally on behalf of other financial institutions and donors. These could become recognised clearing houses for the validation and verification of recipients of funds, and also apply more harmonised and comparable standards for processes across jurisdictions. Many banks are also reliant on clearing banks and corresponding banks when it comes to operating internationally, and this can present challenges in terms of

the interpretation of risk.¹⁶ Government may be able to play a part here by offering guarantees to mitigate some of this risk and thereby remove unnecessary barriers to cross-border giving.

There is also scope to consider whether fintech or regtech solutions might present opportunities to reduce or tackle AML and CFT challenges. For example, decentralised ledger technology could potentially have a significant positive impact on de-risking by offering a highly secure framework in which transactions can be recorded without reliance on a single traditional trusted third party. Similarly, there may be opportunities to harness machine learning and big data to create far better predictive models of risk and early intervention.

Conversely, of course, the application of fintech or regtech solutions may end up presenting new challenges for civil society: for instance if algorithmic systems come to reflect or even strengthen existing biases against CSOs when it comes to allocating risk ratings or determining eligibility for financial products. This might significantly exacerbate current challenges, as many automated systems operate as "black boxes" so it is almost impossible to determine why a particular

other relevant entities such as banks, financial regulators and other financial service providers'. Such fora for addressing financial access challenges exist for example in the United Kingdom, the Netherlands and the United States.

VENRO (2020): Preventing terrorist financing in the NPO sector. Measures to mitigate the risk of terrorist financing in the NPO sector in Germany. Online: <https://fatfplatform.org/assets/venro-bericht-prevention-20209-UA-1.pdf>; Global NPO Coalition on FATF (2018): International Stakeholder Dialogue: Ensuring Financial Services for Non-Profit Organizations. Online: <https://fatfplatform.org/news/international-stakeholder-dialogue-ensuring-financial-services-non-profit-organizations/>

¹⁵ Regulatory action is already happening in this space with the European Commission's new action plan on AML/CFT includes a Harmonised Rulebook also covering more clearer rules on customer due diligence (using the principle of 'same business - same risks - same rules'), and it will also align the process of identifying beneficial ownership across the EU.

¹⁶ Correspondent banking relationships are at the heart of the global payment systems and allow organisations and individuals to make cross-border payments. But bank de-risking had also an impact on the decline of correspondent banking relationships, which decreased by 25% globally between 2009 and 2016. See: Accuity (2017): The costs of de-risking infographic. Online: <https://accuity.com/resources/the-costs-of-de-risking-infographic/>

decision has been made or what kind of resource might be available for CSOs on the wrong end of such decisions.

The risk of these kinds of unintended consequences does not mean the use of fintech should not be explored further, but does make clear that any such exploration must be done in partnership with civil society if our overall goal is to make things better, rather than worse, when it comes to enabling cross-border giving that can support the vital work of civil society around the globe.

Looking ahead

The fight against anti-money laundering and the financing of terrorism is crucial to ensuring the safety and stability of civil society around the globe. But we must also take care to ensure that our efforts to combat these dangers do not come at too high a cost for civil society.

Past policy action at an international and EU-level has already curtailed the ability of

many CSOs to move funds across borders, and it is important that new regulatory initiatives such as the European Commission's new action plan for a comprehensive Union policy on preventing money laundering and terrorism financing takes note of this.¹⁷ But much more needs to be done beyond that to mitigate the wider impact of regulation on civil society, equip stakeholders with affordable resources to enhance knowledge and compliance, and significantly change the risk allocation for the sector.

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¹⁷ European Commission (2020): Action plan for a comprehensive Union policy on preventing money laundering and terrorism financing, Online:

https://ec.europa.eu/info/publications/200507-anti-money-laundering-terrorism-financing-action-plan_en