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Risk and Consequence: The Future of FATF Recommendation 8 for Financial Integrity and Civil Society

Summary-report from the two-day multistakeholder conference



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Risk and Consequence: The Future of FATF Recommendation 8 for Financial Integrity and Civil Society

Organised by the GIZ Global Program Combating Illicit Financial Flows (GP IFF), EU Global Facility on AML/CFT, and the Global NPO Coalition on FATF in Bonn from 26.-27.09.2023

The conference was attended by 110 in-person participants and an average of 30 virtual participants ranging from public sector institutions including the German Federal Ministry for Economic Cooperation and Development, the German Federal Ministry of Finance, the UK Foreign, Commonwealth & Development Office (FCDO), the US Treasury, the European Banking Authority (EBA), the European Commission, the French Treasury, the Dutch Ministry of Finance to international organisations such as the Financial Action Task Force (FATF) and FATF-style Regional Bodies (FSRBs) like MONEYVAL, ESAAMLG and GAFILAT, the UN, and the World Bank, to civil society organisations, think tanks and academia. A variety of topics around FATF Recommendation 8 (R.8) was discussed, such as its evolution, current and emerging problems, the overregulation and suppression of non-profit organisations (NPOs), financial inclusion, a risk-based implementation of R.8, and the way forward. These discussions produced a host of valuable insights

and recommendations, which can broadly be divided into the four topics below. All introductory speakers noted the importance of NPOs to building democratic, resilient societies – but fighting terrorist and extremist groups remain equally important; these are complementary processes whose goals should not contradict each other. The process of revising R.8 over the years has brought improvement in the definitions, guidance and understanding of the issue but there is a long way to go until implementation reaches a satisfactory level of compliance and effectiveness. Many (un)intended consequences are still visible globally as an outcome of R.8 (mis)implementation and the broader Countering the Financing of Terrorism (CFT) framework, with civic space shrinking in most of the world ([UNSR Global Study](#)). Many agreed, however, that the risk-based approach is the only way forward towards reducing unintended consequences, and that inclusive and participatory risk assessments are the foundation of the approach.

1.

Challenges of implementing R.8 in a national context

According to participants, the challenges of implementing FATF's R.8 start with the discrepancy between the definition of how the FATF defines the sector (based on function) and the practice in many countries where NPOs are defined as an entity in law – with the two often not being contiguous. While the definition covers those organisations that collect and disburse funds, many countries apply R.8 indiscriminately to all NPOs operating in their territory. This is based on an insufficient understanding of the definition and application of the Recommendation and the risk-based approach by countries that leads to an implementation of R.8 that is not in line with actual risks. When combined with a lack of a proper sectoral risk assessment, low institutional capacity and the threat of being non-compliant it results in knee jerk reactions, often manifested as a high-risk designation for the entire NPO sector. Thus, research by the Asia-Pacific (APG) FATF-style Regional Body (FSRB), done together with the Global Center on Cooperative Security, presented at the conference showed that in most countries' Mutual Evaluation Reports (MERs), gaps in NPO risk assessment as well as a focus on technical compliance over effectiveness are strategic deficiencies. During the conference a panelist from civil society mentioned that law enforcement and supervisory agencies happen to ignore results and implications of risk assessments, due to falling back to a rules-based approach which they mistakenly assume would be fully compliant with FATF-Standards. Besides, there is anecdotal evidence of FATF/FSRB evaluators endorsing restrictive regulatory approaches for the NPO sector despite low

risk levels identified in the risk assessment. This process is reinforced by not involving the NPO sector in the assessment process, which many NPOs globally criticize as being a core issue. According to the research presented at the conference, only 21% of countries being evaluated involved NPOs in the process, whereas 60% just informed them, and only 20% offered the opportunity for NPOs to actively provide comments to the draft report.

Relevance and actuality are further concerns when it comes to the quality of risk assessments. The assessments should be updated on a regular basis in order to have a good understanding of current risks. Besides, they should be conducted several years before the FATF/FSRB mutual evaluation takes place so that policy measures which address the identified risks are already implemented at the time of the evaluation. NPOs also reported that they are exposed to political pressure to rubberstamp outcomes of sectoral risk assessments and pointed to fears about potential reprisals if they raise concerns as to the content of NPO risk assessments. However, part of the reason might also be a lack of capacity of MER assessors. Not enough focus is given to assessing the NPO sector during MERs, with some pointing out that often assessors only spend roughly 30 minutes during a Mutual Evaluation of a country with its NPOs. Finally, risk assessments should not only be seen as vehicles to tighten regulation. The result of a risk assessment can also state that a sector is already over-regulated, implying that supervisors and law makers should lower the regulatory burden subsequently.

2.

Private sector: financial institutions' approach to risk and CFT

NPOs not only face pressure from governments but the private sector also plays a role in facilitating or hindering their activities, with problems around de-risking being prominently discussed in several panels. Participants pointed towards financial institutions' (FIs) risk perception of NPOs in relationship with terrorism financing as one of the factors leading to de-risking, limited access to accounts or making transactions difficult and expensive. Thus, a lack of knowledge on NPOs within the private sector, combined with incoherent risk assessments and responses, often leads banks to prematurely decline relationships with NPOs. Some participants pointed out that banks often engage in unwarranted de-risking – without due attention to individual risk profiles. Banks thus often de-risk because they fear the reputational risks of potential negative media related to cases of terrorist financing in NPOs, although these are exceedingly rare. They also de-risk because their risk understanding is often based on the blanket assumption that the entire sector is, by default, medium or high-risk. Government regulators' lack of guidance/sensitisation often prevents FIs from assigning lower-risk categories where warranted. Participants also pointed out that banks still spend a majority of their time on things not worth their attention – with meager results: only a minute fraction of illegal assets are recovered. Thus, on the one hand, more work

needs to be done to ensure that banks have the information they need to target their effort and to make this effort more proportionate to real risks. On the other hand, more must be invested in technology to demystify the payment flow from bank to corresponding bank to recipient. Technology could be used to assist NPOs, to capture data and evidence, to create evidence trails, etc.

One way to address the challenges between the private and NPO sectors is to continuously maintain a dialogue to strengthen reciprocal understanding between the two sectors. Another solution is better guidelines for banks on how to assess NPO risks. In this vein, the EBA introduced its work on providing an [annex for NPO customers to their existing AML/CFT risk factor guidelines](#) in March 2023, setting out factors banks need to consider when dealing with NPOs. In a national context, the Dutch Banking Association has published [their Sector Industry Baseline](#) which can serve as an excellent starting point for other jurisdictions looking for pragmatic solutions. In July the EBA also issued a joint [factsheet](#) with the EU Commission, explaining to NPOs what type of information they should have available to show to banks, complete with explanations on why banks need this information. This annex to the guidelines will become applicable across the EU in October 2023.

3.

Rethinking risk: a new form of risk assessment, based on an integrated security approach

One topic continuously referenced by numerous participants was the need to rethink risk in order to move away from the securitisation of risk, as it is now inherent in FATF's risk-based approach. It prioritises an understanding of risk in terms of CFT, to the detriment of a multitude of other risks. Risk, as it is understood now, thus fails to assess the totality of potential harm being undertaken and ignores the severity of risks of overregulation. Participants thus pointed out that there needs to be a re-orientation of the bellicose approaches to CFT towards investment in preventing violence, peacemaking, the rule of law, security sector reforms and governance overall.

This would allow for a more complex understanding of risks that is more in line with recent experiences in the Sahel, for example, where a focus on the risks of transnational actors failed to take into account the risks of oppression and repression in response to that, with the resulting rise of militarism and mercenary groups. During the conference a panelist from the FIU Seychelles moreover suggested that NPO sector risk assessments should not only focus on TF risks but also on corruption or ML risks which, dependent on the country context, can be pre-dominant compared to the sector's TF risks.

4.

Responses to the challenges of R.8

In response to the many challenges actors face when applying R.8, many participants pointed to the necessity of dialogue as the starting point for reform, combined with clear guidance on how to treat NPOs for governments and private sector actors. To this end, several countries have piloted tripartite dialogue formats between the government, the private sector and NPOs, such as The Netherlands, the UK, and, soon to follow, Germany, which will have its first roundtable in January 2024.

Other participants demanded that the principle that NPOs must not be designated as obliged entities be disseminated widely in order to lighten the regulatory burden on them. With this in mind, participants mentioned that dialogue on mitigating measures between the financial sector, which is an obliged entity, and NPOs, which are not, is critical. Participants also pointed out the current imbalance between the impact of soft law, like FATF's 40 recommendations, vs. hard law as laid down in international Human Rights conventions. While the latter technically demand higher levels of obligation, in practice these are not being mainstreamed into AML/CFT regulations. To address this, participants recommended adding these hard law provisions to R.8 to achieve a better balance.

When it comes to engaging with the FATF and governments, participants pointed to the necessity of engaging with governments on the one hand while also applying pressure on FATF itself, as the sustained advocacy by the [Global NPO Coalition and its members](#) was one of the main factors that led to the institution of the Unintended Consequences workstream in 2021. This process on unintended consequences also shows that FATF is not only aware of the problems but actively engaged in addressing them.

Regarding the private sector, in order to address de-risking, participants had several suggestions, from requiring obliged entities to report their reasons for not entering into business relationships with customers like NPOs to enabling authorities to assess if their customer due diligence (CDD) is appropriately calibrated, to instituting a legal right to a bank

Recommendations

Beyond the recommendations collected above, several target recommendations were issued during the discussion:

Recommendations for FATF/FSRBs

- ▶ Strengthen the capacities of evaluators, especially on the topic of civil society and provide them with a toolbox to properly address concerns in the MER process related to R.8.
- ▶ Consider the need for an ombudsperson that can be addressed when one finds improper use of FATF standards. Violations/inappropriate implementation of standards should be sanctioned in some manner (e.g., ICRG process for country).
- ▶ Consider an integrated approach to security that takes into account a multidimensional concept of risk (including, e.g., the risk of overregulation);
- ▶ Consider the inclusion of international hard law in guidelines, i.e., higher obligations stemming from Human Rights conventions.

Recommendations for the financial sector

- ▶ Collaborate with the NPO sector to create trainings for employees in AML/CFT departments to increase mutual understanding and the level of trust between sectors.
- ▶ FATF and the Global NPO Coalition should reach out to global multinational correspondence banks to raise awareness about the necessity of NPOs' financial inclusion and the important work they do.

Recommendations for governments

- ▶ Broad integration/consultation of NPOs by government agencies is needed, not only in the context of R.8 but for the broader FATF framework. The input from such consultations needs to be fed into the global FATF discussions at plenary sessions. At a minimum NPOs should be guaranteed a seat at the table for the Sectoral Risk Assessment process for R.8 and during the MER process of the jurisdiction.
- ▶ More evidence-based policies should be implemented i.e., the need for more clarity in regulations and for making decisions of the government more transparent (and having the possibility of challenging the decisions in court).
- ▶ Financial inclusion of NPOs, including the right for a bank account and more precise guidance for FIs when it comes to NPOs as customers are items that government can tackle to address this issue.

Recommendations for the NPO sector

- ▶ Collaboration – NPOs need to cooperate among themselves and with the private and public sector to improve the mutual understanding of AML/CFT norms and how they interact with civic space. This cooperation is also important for the execution of collaborative sectoral risk assessments in jurisdictions.
- ▶ NPOs should document abuses towards them in the context of R.8 misuse and should share them with a strong voice in the global standard-setting processes. Leveraging international networks such as the Global NPO Coalition on FATF and G7/G20 processes should be done more frequently in this regard.

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