

A Critical Exploration of the Impact of the Counter-terrorist Finance Legal Framework on Domestic Charities

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ABSTRACT

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Angela Maria Theresa Fowler

The political response to the terrorist attacks of 11th September 2001 in the United States was swift and decisive, precipitating developments in the arena of counter-terrorist finance policy and legislation which were to have far-reaching consequences. International regulatory bodies, such as the Financial Action Task Force, recognised the potential for non-profit organisations to be exploited in order to raise, store and transfer funds for terrorist purposes, and were thus identified as a key area on which governments should focus their attention. Regulation intended to counter this perceived threat, overseen by the Charity Commission in the domestic jurisdiction (England and Wales), has resulted in responsibilities which may be burdensome for some charities. The regulatory spotlight has also increasingly focused on third party financial partners, such as banks and other financial institutions, on whom charities rely to effectively pursue their charitable objectives.

The research evaluates some of the issues relating to the environment in which charities operate both domestically and overseas that may make them susceptible to abuse. Focusing particularly on the domestic charity sector, the research evaluates how the law is applied, and the impact it is having in practice. Furthermore, the research considers the extent to which the responsibilities imposed by the counter-terrorist finance legal framework may affect their capacity to operate. The research illuminates the points of interaction and potential friction points between the pivotal structures involved in this inquiry: charities, the regulation, the Regulator and financial institutions, as well as highlighting the positive elements of engagement.

A socio-legal approach to the research was taken, to include both doctrinal analysis and qualitative inquiry. A contextual background of the global regulatory landscape is presented, which highlights the complex and often paradoxical inter-connectivity between the actors and forces which exist therein. It is within these complex relationships that regulators seek to address the threat of terrorist financing, potentially influencing the operations and regulatory governance of charities. The empirical data derived from analysis of 34 semi-structured interviews with charity participants and various commercial partners and has focused on three distinct relationships which have been challenging for organisations within the charity sector: engagement with the regulation, engagement with the financial services sector and engagement with the Charity Commission.

The understanding created by the interview data analysis, together with the presentation of material from the doctrinal research makes an original contribution to the available knowledge. The research provides new perspectives in this regard, uniquely analysing the relationships between stakeholders in a number of dimensions, from the perspective of charities. This approach provides insights into the practical implications for domestic charities of implementing counter-terrorist finance regulation and considers the effectiveness of the regulation as it is implemented (the direct effects of the regulation). The implications for charities of other interconnected structures, in *their* implementation of the regulation (indirect effects) is also evaluated in this research. Both direct and indirect effects of the regulation may ultimately affect the operating capability of some charities and their ability to fulfil their charitable purpose.

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CHAPTER 1: INTRODUCTION

1. THE CONTEXTUAL BACKGROUND AND SIGNIFICANT PROBLEM ADDRESSED BY THE RESEARCH

The counter-terrorist finance legal framework has presented significant challenges for charities in the domestic jurisdiction and non-profit organisations globally, both directly in terms of implementation, and indirectly as a result of compliance measures taken by third party commercial partners. This can significantly affect the ability of charities to fulfil their charitable purpose and thus have a detrimental effect on the positive societal impact this may bring.

In the period prior to the terrorist attacks of 11th September 2001, terrorist financing had not been widely recognised as a policy issue warranting a coordinated strategic international response. The political response in the immediate aftermath of 9/11, however, was both swift and decisive, precipitating far reaching developments in policy and legislation targeting financial support to terrorists globally.¹

Under Chapter VII of the Charter of the United Nations (UN), the UN Security Council (UNSC) unanimously adopted Resolution 1373, two weeks after the events of 9/11, which changed the legal landscape relating to terrorism. Terrorist acts were characterised in this Resolution as a threat to international peace and security.² Recognising the centrality of finance to terrorism, and led by the UN, international bodies such as the Financial Action Task force (FATF), the global policy-making body responsible for setting standards in anti-money laundering (AML) and counter-terrorist financing (CTF), developed a strategic response which has gained momentum, recognition and to some extent

¹ Sue Eckert, 'The US Regulatory Approach to Terrorist Financing' in Thomas Biersteker and Sue Eckert (eds), *Countering the Financing of Terrorism* (Routledge 2008) 209.

² UNSC Resolution 1373, UN Doc. S/RES/1373 (2001).

cooperation in the post 9/11 period. Both the UN and the FATF have been pivotal structures in the development of the international CTF framework, with the UN delivering Resolutions requiring the freezing of terrorist assets, for example, and the FATF making recommendations in support of these, as well as providing both influential guidance and enforcement mechanisms to ensure compliance.

The FATF Recommendations impose a duty on national governments to put in place a legal framework to counter the threat of money laundering in the international financial system. In the post 9/11 era its repertoire was extended to include measures to detect and prevent the financing of terrorism. One of the new recommendations was aimed directly at non-profit organisations (NPOs),³ emphasising the vulnerability of the sector to abuse by terrorists, where previously no mention of this sector had been made.⁴ Vulnerabilities identified included the diversion of funds from legitimate channels via NPOs to terrorist organisations.⁵

Terrorist financing is an exceptionally complex crime which this relatively new regulatory framework aims to address. The environment in which terrorists operate is volatile, uncertain and complex. Similarly, the process of financing terrorist activity within this unpredictable environment is uncertain and complex. This often necessitates constantly changing and diversifying funding sources to ensure a constant supply, avoid detection and take into account evolving CTF regulatory practices. The end of the Cold War signalled a change in the nature of terrorist financing, and terrorists turned to alternative sources of funding and logistical support as the incentive for the superpowers to fund

³ The FATF terminology 'Non-profit Organisation' (NPO) to describe organisations that have a broadly charitable aim when raising and distributing funds will be adopted in this thesis. Such institutions may be referred to elsewhere as Non-governmental Organisations, (NGOs) Civil Society Organisations or charities. The term NPO however is intended to encompass all the aforementioned, except in the case of charitable organisations in the domestic jurisdiction which will be referred to as charities.

⁴ Financial Action Task Force, 'FATF IX Special Recommendations 2001' (FATF/OECD 2001) Recommendation VIII.

⁵ FATF, 'International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation' February 2012 (FATF/OECD 2012).

proxies in the pursuit of geopolitical goals diminished significantly.⁶ Napoleoni contrasts state sponsorship of terrorism to the 'privatisation of political violence'; a model involving an individual group formulating their own strategic approach to further their cause, making their own decisions as to whom they target for support with the ability to generate the funds necessary to assure their survival.⁷ Such funds may derive from both legal and criminal activity. The relationship between some criminal and terrorist groups may be one of cooperation and collaboration, some having structural similarities and common enemies in the form of both the State and law enforcement agencies.⁸ This interaction may also take place within the operating environment of NPOs in areas of political instability thus increasing their vulnerability. This may include physical danger for charity workers, for example from kidnap for ransom, which has become a lucrative funding stream for terrorists, but also the danger of unwittingly contravening counter-terrorist finance regulation in the course of their work.

The perceived vulnerability of NPOs led to pressure on governments to impose a range of due diligence requirements targeting their donors, partners and beneficiaries. In the domestic jurisdiction this has resulted in additional responsibilities for trustees as custodians of their charities, which could be burdensome for some as they navigate a profusion of requirements mandated by charity law and other legislation such as the Trustee Act 2000. Issues relating to sanction regimes, which are integral to the CTF regulatory framework may also further complicate the regulatory landscape for organisations such as NPOs, and present practical challenges with respect to regulatory compliance.

Issues which contribute to this complex picture in terms of the response to a global problem include the lack of a universally accepted definition of terrorism

⁶ Jean Giraldo and Harold Trinkunas, 'The Political Economy of Terrorism Financing' in Giraldo and Trinkunas (eds), *Terrorism Financing and State Responses: A Comparative Perspective* (Stanford University Press 2007) 9.

⁷ Loretta Napoleoni, *Modern Jihad Tracing the Dollars Behind the terror Networks* (Pluto Press 2003) 50.

⁸ Tamara Makarenko, 'The Crime Terror Continuum: Tracing the Interplay Between Transnational Organised Crime and Terrorism' (2004) 6 *Global Crime* 129,130-131.

and by extension, of terrorist financing as a distinct criminal offence, and the potential for states to create a restrictive environment in which certain groups could have their freedoms curtailed, including NPOs, using adherence to CTF legislation as justification.⁹

The regulatory spotlight has also increasingly focused on third-party financial partners on which NPOs rely to carry out their operations. As well as requiring banking facilities, NPOs may also rely on vehicles such as Informal Value Transfer Systems (IVTS), Wire transfers, Money Service Businesses (MSBs) and cash couriers in order to transfer funds in the course of their business. The intensified regulatory scrutiny on these financial partners has, in some cases, affected the ability of NPOs to operate successfully.

Possibly the greatest indirect impact of the regulatory framework has resulted from the burden imposed on the financial services sector. The responsibility for gathering of financial intelligence, for example, is largely devolved to the banking sector in a 'public/private' partnership, and this regulatory burden, together with the chilling effect of huge fines for non-compliance, has contributed to the more restrictive and cautious approach now taken by banks toward their clients. The impacts of banks 'de-risking' and removing their services from organisations considered high risk has been felt by NPOs, for example, where the risk posed may outweigh any financial benefit accrued by the banks.

2. THE EXISTING LITERATURE AND THE CONTRIBUTION OF THIS WORK

This section sets out the gap which is addressed in the research. However, further reference is made to this and other existing literature which is discussed in detail throughout this work.

⁹ The Observatory for the Protection of Human Rights Defenders (OBS), 'Violations of the right of NGOs to Funding: From Harassment to Criminalisation' (OBS 2013) 7-8.

In the domestic arena research has highlighted poor financial abuse management/risk awareness and policies.¹⁰ The challenges with regulatory compliance relating to the CTF framework have not been studied in any depth across a broad spectrum of charities, however. There is therefore a need to ascertain where the challenges lie and the potential barriers to compliance, which is addressed in this research. Trustees have ultimate responsibility for the control and administration of the charity. In cases of non-compliance they risk not only criminal liability, but also the reputation of the charity, which could affect donor confidence and their relationships with third-party commercial partners. Charities ultimately have to comply with the regulation and be able to demonstrate compliance. Investigation by the Charity Commission and adverse publicity damages not only the charity concerned, but also the reputation of the whole sector. Thus, the penalties for ‘getting it wrong’, in terms of reputational damage may be severe.

Previous studies have highlighted certain aspects of the regulatory framework which have affected the ability of some charities to operate. For example, for organisations distributing humanitarian aid, particularly in unstable geographical areas, the impact has been particularly acute.¹¹ This was also highlighted in a study commissioned by the Humanitarian Policy Group, which further concluded that aid operations in conflict areas were subjected to an unprecedented level of public scrutiny due to the rise in online media.¹² Thus certain charities operate under particularly difficult circumstances, and their perceived compliance with regulation and risk profile they present may also affect the willingness of other service providers, such as banks, to deal with them.

¹⁰ Charity Commission and Institute for Chartered Accountants in England and Wales (ICAEW), ‘Financial Controls and Risk Awareness’ (Report, 2012).

¹¹ Kate Mackintosh and Patrick Duplat ‘Study of the Impact of Donor Counter-terrorism Measures on Principled Humanitarian Action’ (Independent study commissioned by OCHA and Norwegian Refugee Council 2013).

¹² Victoria Metcalfe-Hough, Tom Keatinge and Sara Pantuliano, ‘UK Humanitarian Aid in the Age of Counter-terrorism: Perceptions and Reality’ (Humanitarian Policy Group 2015).

The impacts of banks 'de-risking', and removing their services from organisations considered high risk, were investigated in a major study in the US to ascertain whether this was in fact a problem for the NPO sector. The analysis clearly suggested "a serious and systematic problem that must be addressed."¹³ A further study concluded however that there was little empirical data concerning the nature of the relationships exited as a result of banks de-risking.¹⁴ Many organisations clearly would not wish to publicise the fact that financial services had been withdrawn, fearing the adverse effect this may have on donor confidence.

The problem of bank de-risking has also been investigated in a recent UK study.¹⁵ The theme of unintended consequences of the legislation with respect to banks, and the effect of de-risking, more specifically on UK charities, is explored by Keatinge.¹⁶ This and other studies have also concluded that the obstacles faced by Muslim charities, may be more stringent,¹⁷ and the question of bias against Muslim charities therefore also arises. These issues are of immediate concern to many organisations within the sector, representing an existential threat for some, and curtailing the ability of others to fully meet their charitable objectives, therefore warranting further investigation.

The UK government acknowledges the vital work of charities, which underlines the importance and relevance of this study. The charitable income, for example, regulated by the Charity Commission in one year totalled £79 billion.¹⁸ It is not only the size of the sector that underlines its importance but also the range of services provided both in the UK and overseas, which often fulfil a function which may otherwise fall to the government, and certainly in some cases

¹³ Sue Eckert, 'Financial Access for US Nonprofits' (Charity and Security Network 2017).

¹⁴ Tracey Durner and Liat Shetnet, 'Understanding Bank De-risking and its Effects on Financial Exclusion: An Exploratory Study' (Global Center on Cooperative Security/Oxfam 2015).

¹⁵ David Artingstall, Nick Dove, John Howell and others, 'Drivers and Impacts of De-risking' (Commissioned by the Financial Conduct Authority, 2016).

¹⁶ Tom Keatinge, 'Uncharitable Behaviour' (DEMOS 2014).

¹⁷ As summarised by Gordon Stewart and Sherine El Taraboulsi-McCarthy, 'Counter-terrorism, Bank Derisking and Humanitarian Response: A Path Forward' (Humanitarian Policy Group August 2018).

¹⁸ Charity Commission, *Annual Report 2018-2019* HC 2318 12.

contributes to the overall governmental overseas aid commitment. Other organisations exist, for example, to hold those in power to account or to champion the protection of human rights. Thus, any potential negative effects of CTF regulation on charities could have a far-reaching impact on their operating capability and ultimately on the people they serve. Organisations which have a legal charitable status enjoy certain tax exemptions. Thus, if a charity is found to have supported terrorist activity, knowingly or unknowingly, public funds may indirectly have been used to this end due to the tax privileges accorded to the charity. As charities enjoy a unique status, and fulfil functions which are highly valued within society, the general public and the media take an intense interest in cases of alleged wrongdoing. This has serious implications for the charity and its ability to operate, and wider implications for public trust and confidence in the sector. The Charity Commission, therefore, has an interest in assisting charities in navigating the maze of regulatory compliance, demonstrating its ability to detect non-compliance and to deal adequately with this. The role of the Charity Commission therefore is pivotal to this discussion.

Prior research therefore indicates that there are significant issues with regulatory compliance within the domestic charity sector, however, a comprehensive evaluation of its implementation and effectiveness is lacking. A review of the contemporary literature helped inform the current research design in recognising limitations with prior methodologies and identifying pertinent research questions to be explored with the participants, from which useful conclusions could be drawn.

3. RESEARCH QUESTIONS AND OBJECTIVES

As outlined previously, the available research does not adequately address the complexities of the regulatory environment and the consequent effect it has on domestic charities. The focus of this research, therefore, is on the relationship between the CTF legal framework and the NPO sector,¹⁹ defined as vulnerable

¹⁹ The FATF terminology 'Non-profit Organisation' (NPO) to describe organisations that have a broadly charitable aim when raising and distributing funds will be adopted in this thesis. Such

to abuse for terrorist financing purposes and the subject of regulatory attention. The research focuses more specifically on implementation, and the effects of CTF regulation on charities in the domestic jurisdiction.²⁰ Having established that there have been significant challenges with implementation of the regulation, and given the importance of the charity sector to society, the research was designed to explore these issues, build on current knowledge and contribute to the debate more generally through both doctrinal and empirical enquiry. The overarching research questions this thesis answers are: To what extent is the counter-terrorist finance legal framework effectively implemented by domestic charities? And how does the counter-terrorist finance regulatory environment affect the capacity of domestic charities to fulfil their charitable purpose?

The interconnectivity between individual charities, the regulation, the Charity Commission and financial institutions is complex and uncertain. It is also within these complex relationships that regulators seek to address the threat of terrorist financing. Regulation, however, continues to evolve as further learnings about the combinatorial effects from each of the interconnected elements of this complex ecosystem are understood, and enable novel and contemporary responses to the evolving threat. Hence it is important to understand how the individual stakeholder organisational groupings respond within this dynamic environment, and how these responses can affect the entire ecosystem. For example, financial regulators may respond to incidences of terrorist financing by taking a more punitive approach towards banks, and banks in response may adopt a risk-averse strategy toward charities.²¹ The

institutions may be referred to elsewhere as Non-governmental Organisations, (NGOs) Civil Society Organisations or charities. The term NPO however is intended to encompass all the aforementioned, except in the case of charitable organisations in the domestic jurisdiction which will be referred to as charities.

²⁰ Although the regulatory requirements affect charities throughout the UK, the thesis focuses on charities under the jurisdiction of the Charity Commission for England and Wales. Similar independent bodies oversee the regulation and registration of charities in Northern Ireland and in Scotland as separate entities, which nevertheless work closely together.

²¹ Chapter Five s.5: Chapter Seven 3.2.

perceived control the Charity Commission has over the sector may influence the banks' risk assessment with respect to charity clients.²²

Therefore, this thesis evaluates some of the issues pertaining to the perceived vulnerability of the NPO sector and their position within this relatively new and dynamic regulatory framework, which may affect the regulatory burden imposed, and asks:

- What are the challenges relating to the environment in which NPOs may operate, and are they susceptible to abuse for the purpose of financing terrorism?
- How has the regulatory environment evolved and are there any unintended consequences flowing from the implementation of the regulations?

In order to address the overarching research questions, aspects of the engagement of charities with the pivotal structures involved in this inquiry; the regulation, the Regulator and third-party financial partners also need to be addressed, and as such the research asks:

- How are the regulations implemented in practice?
- To what extent does the regulation impact on the operations of charities?
- How does the relationship with the Regulator affect charities' understanding of the regulation, and their level of compliance with the regulation?
- To what extent do matters of regulatory compliance impact on relationships between charities and financial institutions?

²² Chapter Eight s.4.3.

4. OVERVIEW AND STRUCTURE OF THE THESIS

This research is designed to explore the interconnecting relationships outlined above by taking a systemic approach and considering how each component influences the other, with the charity sector at the heart of the discussion. This is achieved by combining doctrinal analysis, including a desk-based review of the literature and prior empirical studies, and qualitative inquiry. The research is presented in seven further chapters, with a final concluding chapter summarising the findings and making recommendations.

The initial contextual background of the environment of terrorist financing and the regulatory landscape highlights the connectivity between actors and forces which exist in this environment. This is intentionally scoped to be broad and wide-ranging to enable subsequent consideration of the indirect as well as the direct impact of such actors and forces on the regulatory approaches of the charities studied in this work. This allows consideration to be made of the complexity of the interrelationships between the various actors, as well as the evolving regulatory practices. The broad landscape overview therefore enables a non-binary consideration of the regulatory compliance/operational practicality spectrum. Later in this work this tension is analysed by categorising the direct and indirect effects of the regulatory environment on charities in the domestic jurisdiction. This research explores further the engagement of charities with the pivotal structures involved, mentioned in the previous section, exploring how the law is applied and plays out in practice. This approach enables a clearer insight than previous research has provided into the specific challenges that compliance with CTF regulation presents.

Addressing the research questions and contributing to the debate, the research is presented as follows:

The research methodology is introduced in Chapter Two. The postpositive epistemological approach and an ontological position of critical realist are coherent with the overall research design, which incorporates doctrinal

research, interactive data collection and a thematic analysis of the qualitative data.

In Chapter Three, some of the issues are discussed which relate to the environment in which those seeking to finance terrorism may operate, which illustrates the multi-faceted and complex nature of this financial crime. The requirements of financing, which may be for organisational as well as operational purposes, have also evolved and are constantly changing. The means by which funds are procured and disseminated reflect the multiplicity of sources available, both legal and illegal and the variety of means by which funds and value may be transferred.

There are a number of specific characteristics which are discussed in this chapter; the unique operating environment; the status of individuals working within charitable organisations; and the constitution of these organisations themselves, which have been identified as rendering them susceptible to abuse. Islamic charities in particular, since 9/11, have been viewed with suspicion, particularly by policymakers in the US, affecting public perception of the risk they pose.²³ Some of the factors which have contributed to this view are discussed here. This chapter also provides contextual background and addresses some of the wider issues within this complex dynamic ecosystem which influence the developing regulatory framework.

Some of the consequences of this are discussed in Chapter Four, in the discussion of the challenges to policymakers and law enforcement agencies in regulating, intelligence gathering and disrupting financial flows. These funding streams may have come from legal sources and possibly transferred using normal banking channels, or other less transparent vehicles, but may nevertheless be indiscernible from funds being transferred for legitimate purposes. This chapter explores the evolution of the regulatory framework and some of the unintended consequences flowing from its implementation by

²³ Jude Howell, 'Commentary: Crises, Opportunities and the Elephant in the Room' (2011) 7 *Journal of Civil Society* 265, 266-267.

governments. The direct impact of the regulation on charities is explored here, and in subsequent chapters of this work.

Chapter Five narrows the focus to consider the UK's strategic response to the threat of terrorist financing: a vital component in the protection of national security.²⁴ In contrast to the US and many other countries, the UK had a well-developed counter-terrorist finance regime in place prior to 9/11, reflecting previous experiences with domestic terrorism. The policy basis for intervention by the regulator, the Charity Commission, is outlined in this chapter together with the requirements for charity trustees, as custodians of their charity, to undertake due diligence in compliance with charity law and, on a personal level, comply with relevant legislation such as the Terrorism Act 2000. Such compliance may be both costly and burdensome. This chapter therefore addresses the question of how the regulation is implemented in practice and discusses how this may impact on the operation of charities.

The role of the financial services sector is examined in the final section of this chapter; providing financial intelligence, their role in the implementation of the asset freeze regime and relationship with other financial structures such as MSBs, providing background and context, in particular for Chapter Seven. The interconnectivity between the two sectors and the question of risk is also highlighted. In some cases, this has led to account closures, both for MSBs and charities, and the implications for charities are explored with participants from both sectors in Chapter Seven.

Chapters Six to Eight each focus on aspects of the engagement of domestic charities with the pivotal structures involved; the regulation itself; the financial services sector and the Charity Commission. The understanding created by the interview data and doctrinal analysis illuminates the points of interaction and points of friction between these pivotal structures as well as highlighting positive elements of engagement.

²⁴ HM Government, *CONTEST: The United Kingdom's Strategy for Countering Terrorism* (Cmd 9608 2018).

In Chapter Six, the framework for analysis of the data, designed to contextualise the participants' comments, comprises two dimensions; awareness of the regulation and responsiveness to the regulation. These variables were used to construct a 2x2 matrix, to explore the two dimensions of this behaviour and to interpret the themes that had been identified, addressing the question of how the regulations have been implemented in practice, the effectiveness of the implementation, and the extent to which the regulation has impacted on the charities' operations.

In Chapter Seven a similar model is employed to explore the nature of the relationship between charities and their commercial partners in the financial services sector. The variables chosen for the matrix in this case involved the nature of the relationship between the parties on a continuum from reactive and confrontational to collaborative and partnering and, on the second axis, the level and/or complexity of charities' banking requirements. This addresses the question 'to what extent do matters of regulatory compliance impact on relationships between charities and financial institutions?'

The empirical evidence relating to the relationship between charities and the Regulator is also presented using thematic analysis, discussing the engagement with the Charity Commission in both its advisory and regulatory roles in Chapter Eight. Firstly, the advisory relationship is analysed within the chapter, including charities' experiences with alternative means by which advice is filtered. The second part of the chapter explores various themes relating to perspectives of the regulatory role of the Charity Commission from clients and stakeholders. This addresses the question of how the relationship with the Regulator affects both the understanding of charities of the regulation and their level of compliance with it. The relationship, and perception of their respective roles, between the financial services sector and the Charity Commission is also discussed in this chapter.

The understanding created by the interview data analysis, together with the presentation of material and analysis of the doctrinal research makes an original contribution to the available knowledge. It provides insight into the practical implications for domestic charities of implementing counter-terrorist finance regulation (the direct effects of the regulation) and the implications for charities of other interconnected structures such as banks, in their implementation of the regulation (indirect effects). The conclusions and recommendations are presented in Chapter Nine.

In the analysis of the relationships between stakeholders in a number of dimensions, from the perspective of charities, the research highlights the challenges as well as the positive elements of implementation of the regulatory framework, thus building on current knowledge and contributes to the debate more generally. Some of the insights into the impact of the regulatory framework include the perception of cost/benefit of compliance, the availability of information and guidance in relation to regulatory matters, the availability of expertise within charitable organisations as well as the relationship charities have with third party commercial partners and the Charity Commission. All of these factors may affect their implementation of the regulation, their operating capability and ultimately their ability to fulfil their charitable purpose.

Given the importance of the domestic charity sector, as outlined above, it is essential that the balance between regulatory compliance and operational practicality is not weighted too heavily towards compliance whilst losing sight of the ultimate objectives of charitable purpose and the positive impact this can have. As such this research may be of interest to charities, umbrella bodies, the Charity Commission as policymaker and regulator of the sector and financial institutions providing services to charities.

CHAPTER 2: METHODOLOGY

1. INTRODUCTION

The aim of the research, as outlined in the introduction to the thesis, is to consider and critically evaluate the global counter-terrorist finance (CTF) regulation, focusing on its impact on charities and answering the questions; to what extent is the counter-terrorist finance legal framework affectively implemented by domestic charities? And how does the counter-terrorist finance regulatory environment affect their capacity to fulfil their charitable purpose? This chapter presents the rationale for the approach taken and an explanation of the methodology.

A socio-legal approach was considered to be the most appropriate route to addressing the research question and to gain insight and understanding of the practical implications for domestic charities of the regulation. As part of this approach a doctrinal analysis and qualitative inquiry was undertaken in considering how the law is applied, and how the law plays out in practice. The doctrinal research informed the research design in that the issue of terrorist financing could be explored and an understanding gained as to the position of NPOs within this complex regulatory environment, and issues with the regulatory response identified. A review of the contemporary literature also helped inform the current research design in recognising limitations with prior methodologies and identifying pertinent research questions to be explored with the participants, from which useful conclusions could be drawn. The research thus builds on current knowledge and contributes to the debate more generally.

This current research asks a new set of questions to a new set of participants, and the methodology chosen enables a more personal approach than other methodologies, for example questionnaires, used in some previous studies. The design of the empirical research within the context of semi-structured interviews in an informal setting encourages a more open discussion and allows

for follow-up questioning. The doctrinal research, as well as forming an integral part of the entire research project, may also be applied to other similar and related research themes elsewhere.

2. THE THEORETICAL POSITION

The epistemological assumption forming the basis of this research comes from a postpositivist standpoint, with the search for the truth at its heart, striving to control subjective influences as far as possible, whilst accepting that the context in which the researcher operates influences the researcher.¹ The postpositivist stance is therefore less stringent than the positivist stance, as the latter accepts that an objective reality does exist.²

The postpositivist paradigm may use various instruments to observe and study a particular phenomenon, with the belief that there is no universal truth. Research attempts nevertheless to explore this phenomenon as closely as possible.³ Denzin and Lincoln maintain within this paradigm that 'only partially objective accounts of the world can be produced, for all methods are flawed'.⁴ Crotty also maintains that within this paradigm 'research outcomes are neither totally objective nor unquestionably certain'.⁵

The approach I took to the research was also reflexive, in that critical reflexion on the knowledge produced, as well as on my role as the researcher in the process, is an important element of the research design. Furthermore, such reflexivity is an important element in the pursuit of objectivity.⁶ Qualitative data is recognised as being generated within a context which, for the individual

¹ Virginia Braun and Victoria Clarke, *Successful Qualitative Research* (Sage 2013) 30.

² Joseph Ponterotto, 'Qualitative Research in Counselling Psychology: A Primer on Research Paradigms' (2005) 52(2) *Journal of Counselling Psychology* 126,128-129.

³ Abdul Panhwar, Sanaullah Ansari and Asif Ali Shah, 'Post-positivism: an Effective Paradigm for Social and Educational Research' (2017)45(45) *International Research Journal of Arts and Humanities* 1.

⁴ Norman Denzin and Yvonne Lincoln, 'The Discipline and Practice of Qualitative Research' in Denzin and Lincoln (eds), *The Sage Handbook of Qualitative Research* (4th Edition, Sage 2011)15.

⁵ Michael Crotty, *The Foundations of Social Research* (Sage 1998) 40.

⁶ Jane Ritchie and Jane Lewis, *Qualitative Research Practice: A Guide for Social Science Students and Researchers* (Sage 2003) 20.

participant, means that their understanding of a concept or the practical implications of implementing policy, reflects the individual's own identity and prior experiences, and is thus subjective. This recognition of subjectivity within the qualitative research process also pertains to the perspective the interviewer brings to the discussion. Although subjectivity is considered a positive and intrinsic element of the qualitative approach, a concept referred to by Kvale and Brinkman as 'perspectival subjectivity',⁷ it is necessary to be mindful of unintended bias which may influence the results, 'biased subjectivity.'⁸ I was therefore conscious of the potential for interviewer bias within the empirical research process, deriving from my own values, perspectives and prior professional experience. In a postpositivist approach to research however, the researcher's values, apart from when choosing a topic for research, should have no influence on the research process and researcher/participants' independence should constitute an important guiding principle.⁹

The interviews were approached without preconceptions of the outcome, and in a non-judgmental manner, which was particularly important given the sensitive nature of the material under discussion. There was also a need throughout the qualitative inquiry process to present a credible and authentic voice. The trustworthiness of the data is tied directly to the trustworthiness of the person who collects and analyses the data.¹⁰

The ontological position adopted is critical realist, accepting that multiple constructed realities exist, rather than a single truth. There are differences in reality and a person's perception of reality. Furthermore, knowledge is socially influenced, therefore cannot be understood independently of the actors involved, and this social reality can only be partly accessed, which means that it

⁷ Steinar Kvale and Svend Brinkmann, *InterViews: Learning the Craft of Qualitative Research Interviewing* (2nd Edition, Sage 2009) 213.

⁸ *ibid.*

⁹ Barbara Kawulich, 'Selecting a Research Approach: Paradigm Methodology and Methods' in Claire Wagner, Barbara Kawulich and Mark Garner (eds), *Doing Social Research: A Global context* (McGraw Hill 2012).

¹⁰ Michael Patton, *Qualitative Research and Evaluation Methods* (3rd edition, Sage 2002) 494 and 570.

is not completely open to being discovered or known.¹¹ Trochim describes the postpositivist critical realist position as accepting “all observation is fallible and has error, and that all theory is revisable.”¹²

These assumptions about the nature of knowledge and reality and my understanding of the literature and research practice, are coherent with the overall research design. Ponterotto offers some examples of postpositivism; the use of semi-structured interviews that are informed by the available literature, the establishment of themes prior to the empirical study, and an attempt to code data into these themes,¹³ all of which was included, to some extent, in the design of the present study. This design incorporates an interactive data collection method and a thematic analysis approach to the qualitative data, combined with a structured analytical tool to further sort the data into ‘alternative paradigms’ or ideal types, and find the strength of relationships between variables, as discussed in the following sections.

3. THE SAMPLING STRATEGY

Rather than choosing to contact potential interviewees at random, I pursued a purposive sampling approach, thus identifying those most relevant to the research question posed. As part of this strategic approach I sought to include participants from a wide variety of charities in terms of mission and size as well as representatives from financial institutions and professionals who may provide professional advice, again in the context of the research question, (maximum variation sampling).¹⁴ A further purposive technique employed was ‘snowball sampling’ also known as ‘chain referral sampling’, which is recognised as a useful technique when primary data sources are difficult to find.¹⁵ Several

¹¹ Braun and Clarke (n 1) 27.

¹² William Trochim, ‘Positivism and Post-positivism’ in Research Methods Knowledge Base <https://socialresearchmethods.net/kb/> accessed 1 March 2020.

¹³ Ponterotto (n 2) 127.

¹⁴ A Bryman, *Social Research Methods* (5th Edition, OUP 2015) 408.

¹⁵ Patrick Biernacki and Dan Waldorf, ‘Snowball Sampling: Problems and Techniques of Chain Referral sampling’ (1981)10(2) *Sociological Methods and Research* 141.

participants introduced me to others, to whom I would not otherwise have had access due to the particularly sensitive nature of the proposed discussions.

With respect to charitable organisations, potential participants were identified as persons holding a position of office within the organisation. The target group included charity trustees, CEOs and Finance Directors, who were deemed most likely to be in a position to discuss the topics raised within the interview with some authority.

Charity trustees have a duty to 'exercise such care and skill as is reasonable in the circumstances...'¹⁶ with a similar duty imposed on directors of charitable companies under company law.¹⁷ As such they are permitted to delegate responsibilities, and many of the participants interviewed were finance directors, treasurers or others with knowledge of this particular field of regulation to whom delegated responsibility had been given, in addition to the trustees interviewed.

The charity sector is particularly diverse in the charitable objectives pursued and in the size of the organisation. The aim was to interview participants reflecting this diversity and to gather perspectives from a wide range of charities, hence the strategy to solicit participation from very small to very large charities in terms of size.

It was also anticipated that Umbrella bodies would provide valuable insight into the research topics from the perspective of their members. Organisations focusing on a particular aspect of charity governance, representing a particular group of stakeholders within the sector or a particular specialism readily agreed to participate.

¹⁶ Trustee Act 2000, s.1(1).

¹⁷ Companies Act 2006, s.174.

As the research focuses on the interaction and interconnectivity with the regulation and the Regulator from the perspective of charities, it was important to gain some insight into the position of the Regulator, the Charity Commission. Representatives from the Charity Commission agreed to be interviewed, however requested that the comments they made were not captured by audio recording device nor reproduced in any form, as they had previous experience of misrepresentation, and their remarks taken out of context. Nevertheless, the discussions provided me with very useful and valuable insights, which I could build upon in future interviews with participants from the charity sector.

The interaction between charities and financial institutions with which they transact had been identified as a theme meriting further exploration, both as a result of secondary research but also during the course of the interviews with charity participants, as various challenges in their relationship were highlighted. Although the focus was always directed on the charity sector, it became evident that the viewpoint of stakeholders in the financial services sector would provide greater depth to the research, in particular to offer insight into how the regulation affected them, and as a consequence of this, their perception of the risk that charities may present. This led to a better understanding of the challenges faced by charities when engaging with third parties such as banks and money service businesses on which they rely.

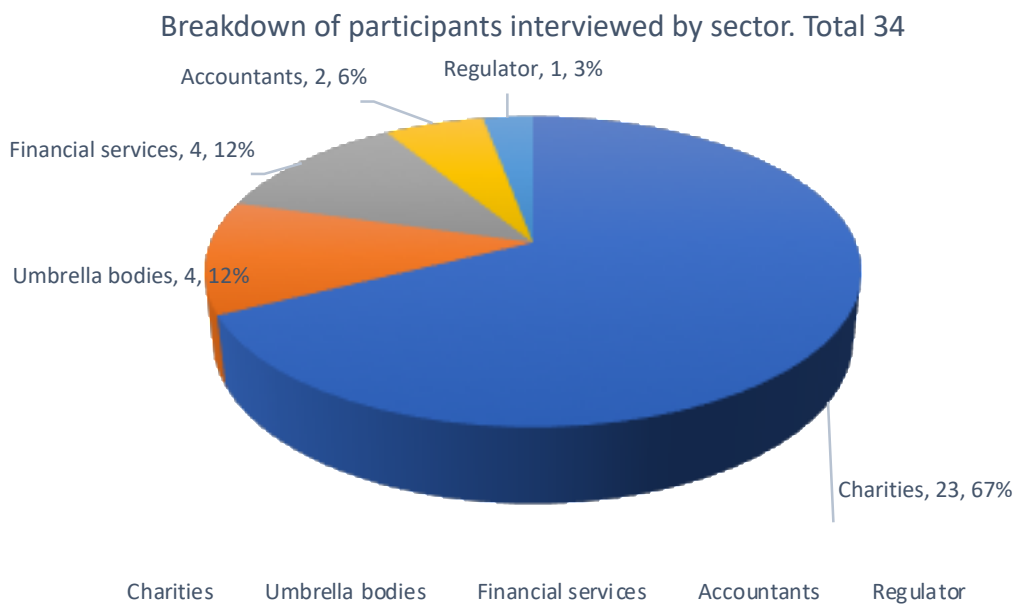
During the initial interviews with charities it also became apparent that one of the sources of information and guidance, with respect to the financial regulation under discussion, came from auditors and accountants. It was therefore relevant to include such stakeholders in the participant group, and their contribution served to illuminate the challenges confronting the Regulator, as well as their own profession, and provided perspective regarding their interaction with their charity clients with respect to the regulation.

The total number of participants interviewed including charities, the Regulator, umbrella bodies and financial institutions amounted to 34, which is considered a sufficiently wide sample to provide data for thematic analysis within the

constraints of a project of this nature.¹⁸ The interviews took place between August 2017 and November 2018. An anonymised list of interview participants describing the type of organisation and date interviewed is annexed hereto.¹⁹

For the purpose of categorisation, several of the participants could have been positioned under multiple sector headings. For example, one charity trustee was also a founding member of an umbrella body and a solicitor specialising in charity law. An accountant also had experience as a trustee, whilst several trustees had formerly been employed by the Charity Commission. The category in which each is placed for the purpose of the following breakdown depends on which role was most prominent during the interview.

Figure 2.1



There is no generally accepted categorisation of size of charity. The invitation to membership of the umbrella group the Small Charities Coalition, for example, is extended to charities with an annual income of less than £1 million.²⁰ For the purposes of this research, however, the categorisation of size of charity utilised

¹⁸ Patton (n 10) 242-244.

¹⁹ List of Interview Participants (Appendix A).

²⁰ Small Charities Coalition <https://www.smallcharities.org.uk/ways-to-join/> accessed 10 October 2019.

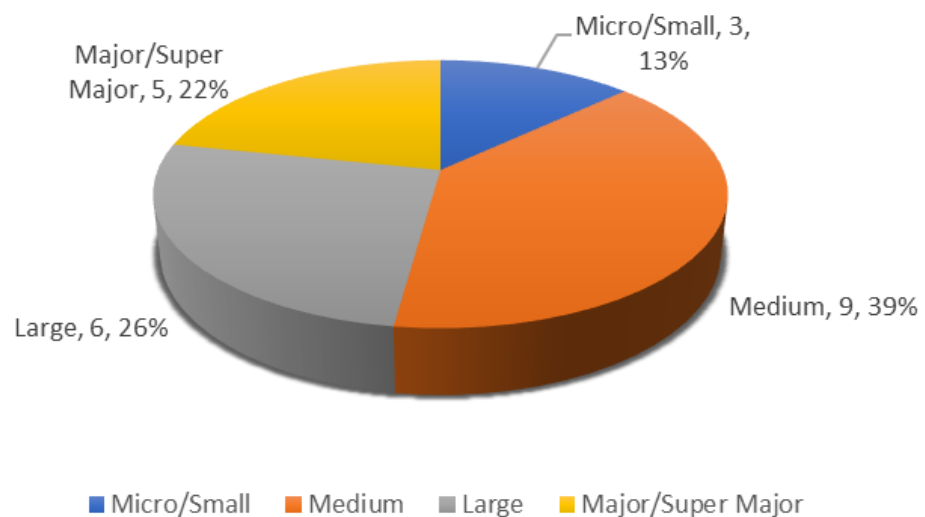
will accord with that outlined by the National Council for Voluntary Organisations,²¹ which classifies charities in terms of annual income:

- Micro..... less than £10,000
- Small..... £10,000 to £100,000
- Medium..... £100,000 to £1 million
- Large..... £1 million to £10 million
- Major..... more than £10 million
- Super major..... more than £100 million

Although the sector is dominated by larger organisations in terms of income (82% of the income derives from those in the large to super-major categories) these represent only 4% of charities in numerical terms. Small charities make up the vast majority of the total charity population (82%) but have a collective income representing only 4% of the total.²² The size of the organisation is not the major defining factor in the present study, it is however an interesting characteristic which is used frequently in the analysis of interview data.

Figure 2.2

Breakdown of individual charity participants interviewed by size of organisation. Total 23.



²¹ National Council for voluntary Organisations (NCVO), 'UK Civil Society Almanac,'(NCVO 2019).
²² *ibid.*

4. DESIGNING AN EVALUATIVE FRAMEWORK-THE INTERVIEW

Ethical approval for the intended research was received from the University of Liverpool Research Ethics Committee on 8th June 2017.²³ All the interviews except two (when two parties were present in each case) were carried out on a one-to-one basis, predominantly in person, although some were conducted via Skype or by telephone, in accordance with the interviewee's preference.

The interviews were semi-structured (rather than a more rigid and structured format) allowing more flexibility in the discussion of topics, in recognition that some topics may be of more relevance than others to the participant, and therefore more time could be spent exploring these.²⁴ This approach allowed the follow up of unanticipated issues, which could provide a rich source of data, and also recognised the diversity of charities represented. The semi-structured approach was also adopted in the questioning strategy to accommodate the reality experienced in earlier interviews, and to ensure that the questioning remained relevant and meaningful to the participants.²⁵ Assurances of confidentiality and anonymity enabled a more open dialogue, with questions framed to encourage participants to give an honest account of their engagement with the regulation and various stakeholders. Face to face interviews, according to Carruthers, are preferable in providing an environment inspiring confidence and openness, provided the interviews are well structured, the interviewee fully understands the purpose of the interview, and anonymity of responses is assured.²⁶

A topic guide was prepared for each of the participant groups in order to retain focus and to provide a framework for the interview.²⁷ The topics discussed within the interview with the Charity Commission, for example, were more

²³ A copy of the final Notice of Ethical Approval for this research is annexed hereto (Appendix B)

²⁴ John Carruthers, 'A Rationale for the use of Semi-structured Interviews' (1990) 28 *Journal of Educational Administration* 63.

²⁵ Braun and Clarke (n 1) 78-80.

²⁶ Carruthers (n 24) 65.

²⁷ Copies of the topic guides are annexed hereto (Appendices C, D and E).

general in nature, with a view to obtaining an overarching view of the sector with respect to the research question.

5. ANALYSIS OF THE DATA

There is no universally recognised method of organising and presenting qualitative data. Established principles of transcribing the data, however, were observed whereby the audio-recorded data gathered from the interviews was personally transcribed verbatim, which served to develop familiarisation with the material.²⁸

The approach to the analysis of data involved an initial detailed reading of the data (immersion), including active reading and making initial notes on stand out themes, which acted as a basis for initial codes.²⁹ The process of thematic analysis was used as a vehicle to understand the various perceptions of the stakeholders involved in the research. This method of analysis avoids preconceived ideas of what the outcome may be. The main themes, which had previously been identified, concerned various aspects of engagement; the engagement of charities with the regulation, with financial services and with the Regulator. Using a deductive approach to data analysis more specific conclusions could be reached based on the experience of the interview participants. The central methodological pillar of the research, based on thematic analysis, possesses a key advantage of allowing flexibility within the analysis. Boyatzis argues though, that this should be viewed, not as a specific method, but a tool to be used across diverse methods to make sense of seemingly unrelated material which increases accuracy or sensitivity in interpreting the data.³⁰ The computer assisted data analysis vehicle NVivo was used to further assist in the identification of relevant sub-themes, to which categories and codes were applied. The codes were constantly reviewed

²⁸ Greg Guest, Kathleen MacQueen and Emily Namey, *Applied Thematic Analysis* (Sage 2012) ch 2.

²⁹ Braun and Clarke (n 1) 204.

³⁰ Richard Boyatzis, *Transforming Qualitative Information: Thematic Analysis and Code Development* (Sage 1998).

throughout the process and the themes formed the basis of the final chapters of the overall research project.

Having analysed the data and identified sub-themes, it became apparent that a further framework for analysis could be usefully applied. Key dimensions/factors were identified which offered interesting variables and allowed summation of the research results, as well as assisting in the contextualisation and grouping of the themes in relation to these variables. Two variables were selected to reflect the nature of the relationship of charities for two of the three areas of engagement; with the regulation, and with financial institutions, as outlined in the introduction to the thesis. Each of these areas formed the basis for discussion in Chapters Six and Seven. To assist with the illustration of the identified themes, each pair of variables was used to construct a 2x2 matrix.

Perceptual maps, as such matrices are sometimes referred to, have been developed to interpret themes from interview data, often used to explore the nature of the relationship a consumer has with a product or service.³¹ This diagrammatic technique is used extensively in marketing in a wide variety of fields including the financial services industry. Huberman and Miles also outline a technique for searching for cross-case patterns in the course of research analysis, in which patterns may emerge from the data gathered from case studies. A 2x2 matrix can be used as an extension of this technique.³²

The Thomas-Kilmann conflict 'mode' instrument further illustrates the 2x2 matrix as an analytical tool mapping two dimensions of behaviour.³³ Rather than considering interpersonal relationships, these techniques have been adapted to consider organisational relationships and thus to suit the requirements of my research.

³¹ Frances Brassington and Stephen Pettitt, *Essentials of Marketing* (3rd Edition, Pearson 2012).

³² A Michael Huberman and Matthew Miles, *The Qualitative Research Companion* (Sage 2002) 18.

³³ Ralph Kilmann and Kenneth Thomas, 'Developing a forced-choice measure of conflict-handling behaviour: The "mode" instrument (1977) 37(2) Educational and Psychological Measurement 309-325.

The research data was categorised and labelled so themes could be summarised on the 2x2 matrices identified. Each of the four clusters therefore resulted in a summary of the combinatory effect of the two themes identified from the data (the two axes on the matrix). Each cluster therefore representing an 'ideal type' or 'alternative paradigm'.³⁴ As an analyst-constructed typology, the type profile is a useful vehicle with which to present qualitative comparisons or thematic contrasts as it represents the interaction between the two variables.³⁵

As the participants clearly viewed the Charity Commission as having two distinct roles; advisory and regulatory, the different elements of the regulator's core function were treated separately in Chapter Eight. Sub-themes identified from the data analysis included a variation in perceived accessibility of advice, and the perception participants had of the Charity Commission as a source of advice and guidance. There were also alternative means by which advice was filtered. These formed the basis of the thematic analysis undertaken in this part of the chapter.

When considering the data relating to engagement with the Charity Commission with respect to its regulatory role it became apparent that the level of direct involvement in regulatory matters varied within the participant group. This ranged from direct experience of a formal inquiry at one extreme, being the subject of preliminary investigations, with no further action taken, or simply entering into a dialogue with the Regulator due to the perceived risk attached to their operations in areas of political instability. The identified sub-themes therefore formed the guiding structure of this aspect of the analysis of engagement with the Regulator. Firstly, the perception of participants as to how the regulator operates and secondly, the perception of participants of how the regulator *should* be operating, were explored in this second part of the chapter.

³⁴ Patton (n 10) 9 and 459.

³⁵ *ibid.*

Throughout the work additional data from other sources has been incorporated into the analysis; existing literature, case law and regulation for example.

6. SOME LIMITATIONS-AND CONCLUSIONS

The participant group was drawn almost entirely from prior contacts both personal and professional, with only two participants, both from umbrella bodies, responding to direct invitations to participate. I was conscious that the participants may have been reassured by a personal connection to some degree and had entrusted me with their views and opinions on delicate matters: touching on aspects of regulatory compliance and financial transactions with an overarching theme of terrorism. This however limited the pool from which participants were drawn.

It was anticipated therefore, due to the highly sensitive nature of the subject matter, certain potential participant groups may be more reluctant to take part, which indeed proved to be the case. Several Muslim charities cited fears of misrepresentation, previous negative experience with journalists posing as researchers, and disinclination to draw attention to their charity and any difficulties they may be having, as reasons for refusal to engage with the research. With respect to ethical considerations, therefore, the participant group was limited to individuals who willingly accepted the invitation to take part in the research.

There is an obvious mismatch between the interview sample group and the general population of charities in terms of size. As mentioned above, the population of small charities within the sector represent approximately 82% of the total, whereas the percentage of micro/small charities interviewed was only 13%. A significantly greater number of larger charities contributed to the research than are represented in the general charity population, with 48% of participants being in the large to super-major categories. In terms of income though, this group in the general charity population represents a substantial

82% of the total.³⁶ Many potential participants from smaller charities, or those with a purely domestic focus, declined the invitation to participate professing to be uncomfortable with the prospect of discussing matters about which they had little knowledge.

The larger charities, however, were more likely to have a representative conversant with the regulation under discussion, the means to put this into practice, and willing to give examples demonstrating that their organisation was compliant. The medium and larger charities especially those conducting operations overseas were therefore more likely to have a higher level of engagement with the regulatory framework, the financial services sector and the Regulator, and for these reasons appeared to engage more readily and willingly with the research. Organisations that were non-compliant either knowingly or inadvertently or had been investigated by the Regulator or law enforcement agencies for serious financial irregularities, terrorist financing offences or actively engaging in financing terrorist activity would have a very interesting contribution to make but would be extremely unlikely to agree to participate.

The participants were therefore to some extent self-selecting, as those who agreed to take part had, for the most part, a connection to me, albeit via a third party in the majority of cases. This may have afforded the potential for researcher bias as noted above. I was, however, conscious of my role, and the relationship with the participants remained impartial, as far as possible. Some participants who had experienced problems in the past, for example, with their banks, were more willing to participate and discuss these issues than others. These participants had typically already aired their grievances in other fora whereas others, whether from a Muslim charity as mentioned above, or from other faith or non-faith charities feared that any discussion, despite assurances of confidentiality, may affect donor confidence more widely.

³⁶ NCVO (n 21).

There are evidently constraints within a research project of this nature in terms of time and resources available, and the quality of data is similarly limited in that there will inevitably be certain gaps. However, the research informs us about the relationship that charities have with counter-terrorist finance regulation in its practical application, with the financial services sector, and with the Regulator. The data analysis identifies significant direct and indirect effects of the regulation which impact on the capacity of charities to fulfil their charitable purpose. This enables conclusions to be drawn and recommendations to be made, which would be of interest to various stakeholders, including the Charity Commission, as well as to charities themselves.

CHAPTER 3: THE ENVIRONMENT OF TERRORIST FINANCING AND THE CHALLENGE FOR NON-PROFIT ORGANISATIONS

1. INTRODUCTION

Terrorist financing involves not only the generation of funds, but of their movement and distribution, quickly and often anonymously across international borders, in such a way as to circumvent scrutiny and detection. Following the money trail, its interception, and obstructing the flow of funds to terrorists is regarded as one of the most important strategies in the fight against terrorism.¹ The Non-profit sector is one of several perceived to present particular challenges and display specific vulnerabilities, which have brought it to the attention of policy-makers in the international arena.² From the perspective of those involved in legitimate non-profit organisations (NPOs) however, the nature of terrorist financing, including such factors as the breadth of activity of those financing terrorism and the multiple modes of transfer of funds available to them, make this area of financial crime particularly challenging to contend with.

This chapter will explore some of the issues concerning the environment in which those seeking to finance terrorism operate and illustrate some of the complexities of this particular financial crime. Firstly, the requirements of terrorists for funding sources will be discussed, considering some of the sources of funding, deriving both from state sponsorship and private sponsorship, with particular focus on the perceived vulnerabilities of certain NPOs which may be exploited for terrorist purposes.

¹ Arabinda Acharya, *Targeting Terrorist Financing: International Cooperation and New Regimes* (Routledge 2009) 9.

² Financial Action Task Force (FATF), 'International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation' Recommendation 8 (FATF/OECD February 2012).

Criminal activity as a source of funding will also be considered, for example kidnap for ransom and other acquisitive crimes which demonstrates the breadth of funding sources available. The relationship between criminality and terror and the apparently seamless movement of some individuals between these activities is a dynamic factor of consideration within the frame of study. Terrorist financing may also be channelled through ostensibly legal activities, where organisations are used as a 'front' for raising funds to support terrorist activities.

The final section of the chapter will examine some of the multiple modes of storing and transferring funds, using both regulated financial systems and the numerous less transparent means available, which further illustrates the multifaceted and complex nature of terrorist financing. This provides insight into the challenges facing global policymakers when formulating counter-terrorist financing interventions.

2. THE CONSTANTLY CHANGING DYNAMICS OF TERRORIST FINANCING

Al-Qaeda's funding sources were reportedly under pressure in the post-9/11 period, which was attributed, at least in part to successful counter-terrorist finance measures instituted by western banks.³ Other commentators also predicted that terrorists would simply become more adept at hiding funds and finding less conspicuous means of moving money.⁴ Donations from traditional sponsors of Al-Qaeda however, were instrumental in the development of a European recruitment drive and by 2005, a network of agents recruiting suicide bombers and fighters to send to Iraq was firmly established.⁵ The financing of

³ Laura Donohue, *The Cost of Counterterrorism: Power, Politics and Liberty* (CUP 2008) 346.

⁴ Don Van Natta, 'The Nation: Terrorists Blaze a New Money Trail' (*New York Times*, 28 September 2003) <http://www.nytimes.com/2003/09/28/weekinreview/the-nation-terrorists-blaze-a-new-money-trail.html> accessed 1 March 2020.

⁵ Loretta Napoleoni, 'The Evolution of Terrorist Financing since 9/11: How the New Generation of Jihadists Fund Themselves' in Sean Costigan and David Gold (eds) *Terronomics* (Ashgate 2007) 14-16.

terrorism, in particular that of jihadist groups, has proved to be dynamic and capable of adaptation to meet new challenges.

The reaction to the attacks of 9/11 were a springboard for the creation of new global anti-imperialist ideology 'Al-Qaedaism', no longer reliant on central funding, the motivating force behind the new age of self-funded terror networks, as exemplified by the London bombings.⁶ The 2015 Report published by the Norwegian Defence Research Establishment concluded that three quarters of terrorist attacks in Europe between 1994 and 2013 cost less than \$10,000, and noted the trend toward self-funding and low-level crime to support these activities.⁷

Napoleoni also notes that recent European attacks were the work of home-grown terrorist groups, some of whom had outside assistance, whereas others were financially independent.⁸ The way the jihadist movement is funded in both the Middle East and Europe has significantly changed. Until 9/11 Europe was considered a fertile ground for the recruitment of fighters for causes overseas and fund-raising for terrorist groups such as Al-Qaeda. The US response to the 9/11 attacks, the war in Iraq and the abuse scandal of Abu Ghraib prison have been cited as major factors influencing this fundamental change, causing a proliferation of home-grown and self-funded jihadist cells.⁹

Keatinge and Keen suggest that terrorists acting alone or in small cells represent a more imminent domestic threat to the UK than IS, given that the latter operates predominantly in Iraq and Syria. The financial flows with respect to this model of terrorism however, is for the most part indistinguishable from financial behaviour for legitimate means.¹⁰ The attack in 2013 of Fusilier Lee Rigby exemplifies the lack of sophistication with which a deadly act of terrorism

⁶ *ibid* 21.

⁷ Emilie Oftedal, 'The Financing of Jihadi Terrorist Cells in Europe' (Norwegian Defence Research Establishment 2015) 7.

⁸ Napoleoni (n 5) 21.

⁹ *ibid*.

¹⁰ Tom Keatinge and Florence Keen, 'Lone-actor and Small Cell Terrorist Attacks: A New Front in Counter-terrorist Finance?' (RUSI 2017).

may be carried out and the low cost involved, in this case the purchase of inexpensive knives. The impact of this attack has been particularly profound, changing our view of the terrorist act in its brutality and the publicity it generated as well as providing the inspiration for numerous subsequent knife attacks.¹¹

A further example of constantly changing methods of financing is the model provided by IS; which is distinctive in many respects from the multiplicity of illegal sources of funding; controlling the derivative fuels market and profiting from the sale of fuel to Syria and Jordan for example to taxation of the local communities under its control. There was a greater and immediate need for funds as they provided the services, which would normally be provided by a state, which necessitated the transportation of large quantities of cash and the use of Money and Value Transfer Systems (MVTs). Foreign terrorist fighters were also a source of funding, although relatively minor in comparison.¹²

In 2016 IS remained the world's deadliest terrorist group, with attacks by IS inspired individuals carried out predominantly in the USA and Western Europe. The deadliest of such attacks on American soil since 9/11 occurred in an Orlando night club in June 2016 by a lone IS-inspired gunman.¹³ From a series of coordinated attacks in Paris in 2015 the trend in mass casualty attacks inspired by IS in Western Europe continued into 2016 in Nice, Brussels and Berlin.¹⁴

Several more recent attacks have involved the use of vehicles as weapons, which appears to be an ongoing trend, requiring very little financial

¹¹ Raffaello Pantucci, 'How Lee Rigby's murder changed the Face of Terror' (*The Guardian*, 15 April 2018) <https://www.theguardian.com/commentisfree/2018/apr/15/day-new-terror-unleashed-lee-rigby-murder-woolwich> accessed 1 March 2020..

¹² FATF, 'Financing of the Terrorist Organisation Islamic State in Iraq and the Levant (ISIL)', (FATF/OECD 2015).

¹³ Robert Johnston, 'Terrorist Attacks and Related Incidents in the US' Last updated 30.12.2019 <http://www.johnstonsarchive.net/terrorism/wrjp255a.html> accessed 1 March 2020.

¹⁴ Institute for Economics and Peace (IEP), 'Global Terrorism Index 2018: Measuring the Impact of Terrorism' (Sydney 2018) 39 <http://visionofhumanity.org/app/uploads/2018/12/Global-Terrorism-Index-2018-1.pdf> accessed 1 March 2020.

investment.¹⁵ The deadliest terrorist attack globally in 2017 also involved a vehicle, with explosives killing 588 people outside the Safari Hotel in Mogadishu.¹⁶

3. STATE SPONSORSHIP AND PRIVATE SPONSORSHIP OF TERRORISM

Some of the sources of funding for terrorism, including NPOs, will be discussed in the following section.

3.1 State sponsored terrorism

Governments have provided, and in some cases continue to provide, logistical and financial support to terrorist organisations. During the cold war years funding was provided by the major powers to various militant groups and death squads throughout the world, often in the guise of providing ‘international solidarity’ or ‘counter-insurgency’.¹⁷ Competing states used terrorism as a vehicle for waging war against each other. In avoiding direct military conflict, which could potentially lead to nuclear confrontation, armed groups were deployed by powers such as the United States and the Soviet Union to pursue politics or diplomacy ‘by other means’.¹⁸ In this cold war period, programmes of foreign aid delivery were often an integral component of foreign policy to complement military as well as commercial aims.¹⁹

Active state sponsorship of terrorism since the 1990’s has declined dramatically, according to Hardouin, as states become more sensitive to international pressure, for example from sanctions regimes, and terrorist

¹⁵ For example; in the UK, The Finsbury Park Mosque attack-June 2017, London Bridge attack-June 2017, Houses of Parliament-August 2018; in Barcelona- August 2017 and Edmonton Canada September 2018.

¹⁶ IEP (n 14)10.

¹⁷ Nikos Passas, ‘Terrorism Financing Mechanisms and Policy Dilemmas’ in Jeanne Giraldo and Harold Trinkunas (eds), *Terrorism Financing and State Responses: A Comparative Perspective* (Stanford University Press 2007)24.

¹⁸ James Adams, *The Financing of Terror* (New English Library 1986) 13.

¹⁹ Jude Howell, ‘The Global War on Terror, Development and Civil Society’ in Alan Fowler and Chiku Malunga (eds), *NGO Management* (Earthscan 2010) 41.

groups finding less willing support from previous state sponsors.²⁰ Aid policy at the same time became less constrained by links to the diminishing ideologically-motivated political rivalries.²¹ The advent of the 'global war on terror' and the shift in emphasis post 9/11 toward linking security and development; the fight against terror with the fight against poverty which resulted in a 'new politics of aid' affected global NPOs with humanitarian objectives, as well as development agencies.²²

There are still numerous groups though which are considered by many to pursue terrorist activities, and benefit from state sponsorship including Hezbollah and Hamas.²³ Some states may also be accused of, whilst not directly sponsoring terrorism, turning a blind eye to activities, which warrant further investigation, and allow minimal oversight of the NPO and financial sectors within their borders.²⁴ Levitt and Jacobson agree that whilst overt state sponsorship is increasingly rare, states however have allowed terrorists access to their territory and as such have facilitated their activities and continue to provide a significant source of support.²⁵

According to the US state department Iran retains its position as the foremost state-sponsor of terrorism.²⁶ In April 2019 this position was further cemented when President Trump made the unprecedented move to designate the Islamic Revolutionary Guard Corps (IRGC) as a foreign terrorist organisation (FTO). Designating another country's army a terrorist organisation is a 'major first on the international stage' imposing financial sanctions and effectively banning US

²⁰ Patrick Hardouin, 'Banks governance and public private partnership in preventing and confronting organised crime and terrorism financing' (2009)16(3) *Journal of Financial Crime* 199.

²¹ Howell (n 19) 41.

²² *ibid* 41-44.

²³ Nikos Passas (n 17) 24.

²⁴ Jonathan Winer, 'Countering Terrorist finance: A Work Mostly in Progress' (2008) 618 *The Annals of the American Academy of Political and Social Sciences* 112, 114.

²⁵ Matthew Levitt and Michael Jacobson, 'The Money Trail: Finding, following and freezing terrorist finances' Policy document 89 (Washington Institute for Near East Policy 2008) 13 <https://www.washingtoninstitute.org/uploads/Documents/pubs/PolicyFocus89.pdf> accessed 1 March 2020.

²⁶ US Department of State 'Country Report on Terrorism 2017' (2018.) <https://www.state.gov/reports/country-reports-on-terrorism-2017/> accessed 1 March 2020.

business with the IRGC.²⁷ Already heavily sanctioned, this further move makes any dealing with Iran even more hazardous and any entity doing so, including for example NPOs operating in areas where the IRGC may also have a presence, would have to proceed with caution. Exemptions to US sanctions though could limit the potential liability for groups such as NPOs. In this instance however the government makes it clear this would not apply to individuals within exempted groups, who could find themselves subject to US sanctions for providing 'material support' to designated terrorist groups.²⁸ NPOs operating in areas of such political instability need to have regard to sanctions listings. For NPOs involved in delivering aid, for example, to Syria,²⁹ again the question arises as to how the relevant sanctions may affect their operations, compounded by the challenges associated with transferring funds when formal banking channels may not be operable, which will be discussed further in the forthcoming chapters.

The US designations are to some extent quite arbitrary with vague criteria for inclusion. Some would argue that Russia fulfils the criteria more fully than North Korea but has never been designated a state sponsor of terrorism, despite cooperating with Iran and backing the Syrian regime, as well as assassinating dissidents abroad, a practice that has been condemned by the US as terrorism when perpetrated by Iran against its own citizens.³⁰ This demonstrates the ideological difficulty in defining what constitutes terrorism and the different interpretation that can accrue for political ends, which will be explored in greater depth in Chapter Four.

²⁷ Natasha Turak, 'How Trump's terrorist designation of Iran's revolutionary Guard impacts it's economy' (CNBC, 12 April 2019) <https://www.cnbc.com/2019/04/12/trump-terrorist-designation-of-irans-irgc-the-economic-impact.html> accessed 1 March 2020.

²⁸ Lesley Wroughton, Arshad Mohammed, Jonathan Landay and others, 'Exclusive: US carves out exceptions for foreigners dealing with IRGC' (Reuters, 21 April 2019) <https://uk.reuters.com/article/uk-usa-iran-irgc-exclusive/exclusive-u-s-carves-out-exceptions-for-foreigners-dealing-with-irgc-idUKKCN1RX0MC> accessed 1 March 2020.

²⁹ *ibid.* Syria has featured on the US list of state sponsors of terrorism since 1979, when the list was first compiled.

³⁰ Daniel Byman, 'Russia is a State sponsor of terrorism, but don't treat it that way' (Brookings Institute, 30 April 2018) <https://www.brookings.edu/blog/order-from-chaos/2018/04/30/russia-is-a-state-sponsor-of-terrorism-but-dont-treat-it-that-way/> accessed 1 March 2020.

Aside from some notable examples, as illustrated above, overt state sponsorship of terrorism has declined and, as a consequence, diversification of fund-raising activity has expanded.³¹ The generation of funds therefore may migrate to the realm of private sponsorship, for example targeting diaspora communities, as well as generating and moving funds through NPOs by a variety of means.

3.2 Private sponsorship of terrorism

3.2.1 Diaspora communities as a funding source for terrorism

Gunaratna outlines the importance of understanding the mechanisms whereby a terrorist group ensures the survival of its support network, which is crucial to the survival of the group itself.³² This support network is increasingly drawn from transnational diaspora communities establishing emotional and operational links with conflicts in their homeland. The impact of conflicts and the call to jihad in countries such as Chechnya, Afghanistan, Kashmir, Syria and Iraq resonate with Muslims living in the West.³³

Several attacks on western soil have been planned, funded and carried out by radicalised Muslim groups from diaspora communities. The Madrid train bombing by African migrants and the foiled attempt by a British cell to bomb underground car parks and tube stations led by British born Hindu convert to Islam Dhiren Barot, both in 2004 provide examples of cells acting independently of recognised terror groups.³⁴ There are numerous other examples of demands for 'taxes' by terrorist groups in Europe and elsewhere.³⁵

³¹ Loretta Napoleoni, *Modern Jihad Tracing the Dollars Behind the terror Networks* (Pluto Press 2003)33; Giraldo and Trinkunas (n 17)19; Acharya (n 1)7 (Targeting Terrorist financing).

³² Rohan Guneratna, 'The Terror Market: Networks and enforcement in the West' (2006) 27 *Harvard International Review* 66, 67.

³³ *ibid.*

³⁴ *ibid* 69.

³⁵ Including; the LLTE in France, John Solomon and B.C Tan, 'Feeding the Tiger: How Sri Lankan Insurgents Fund Their War' [2007] August, *Jane's Intelligence Review* 19; the PKK throughout Europe, Bruce Hoffman, 'The Radicalization of Diasporas and Terrorism' (Joint Conference, Rand/The Center for Security Studies Zurich 2007) 2; Abu Sayyaf (ASG) in the southern Philippines, Jonathan Winer and Trifin Roule, 'Fighting Terrorist Finance' (2002)44 *Autumn Survival* 87-104, 89.

Hezbollah receives significant backing from wealthy Lebanese ex-patriots typically living in places where there are large Shi'a populations in Africa and South America.³⁶ Naím gives the example of diaspora Lebanese groups settling in areas of West Africa where weak governance allows the perpetration of acquisitive crime through illicit networks, and the monies raised used to fund their cause and gain power and influence within the failed state.³⁷

During a raid on the offices of the Benevolence International Foundation in Sarajevo, the top 20 Saudi financial sponsors of Al-Qaeda appear to be listed in a seized document.³⁸ The so-called 'Golden Chain' list named twelve businessmen, two former government ministers and six bankers, the latter having associations with the three largest banks in Saudi Arabia. Furthermore, most of the donors listed were either founders or board members of charitable foundations.³⁹ The source of this evidence has proved very controversial, and sparked libel actions in the High Court in London: several prominent Saudis such as Khalid bin Mahfouz succeeding in securing judgements in his favour, as well as retractions, against several authors and publishers.⁴⁰

Links between Qatari nationals and terrorist groups in Syria and Iraq have also been reported. The former defence secretary Dr Liam Fox speaking of IS stated that 'money has been flowing from rich individuals in the Gulf states, if not their governments, to finance them and their Sunni allies...'.⁴¹ Officials in the US have

³⁶ Scott Wilson, 'Lebanese Wary of Rising Hezbollah' *The Washington Post* (Washington DC, 20 December 2004) <https://www.washingtonpost.com/archive/politics/2004/12/20/lebanese-wary-of-a-rising-hezbollah/a09fad05-e608-4b58-97da-fcb0971bcda3/> accessed 1 March 2020.

³⁷ Moisés Naím, *Illicit* (Arrow books 2007) 263.

³⁸ Millard Burr and Rachel Ehrenfeld, 'Saudi Arabia: The Golden Chain and the Missing 28 Pages' (American Centre for Democracy, 23 April 2016) <https://acdemocracy.org/saudi-arabia-the-golden-chain-and-the-missing-28-pages/> accessed 1 March 2020.

³⁹ Jean-Charles Brisard, 'Testimony Before the Committee on Banking Housing and Urban Affairs' (United States Senate 22 October 2003) 3. <https://www.banking.senate.gov/imo/media/doc/brisard.pdf> accessed 1 March 2020.

⁴⁰ Robert Collins, 'The Saudi Billionaire v Cambridge University Press' (Columbian College of Arts and Sciences) <https://historynewsnetwork.org/article/42436> accessed 1 March 2020.

⁴¹ Robert Mendick, Tim Ross and Patrick Sawyer, 'Army chiefs tell Government: Stop Gulf States funding terrorism' *The Telegraph* (London, 4 October 2014) <http://www.telegraph.co.uk/news/worldnews/middleeast/iraq/11141539/Pressure-on-Government-to-take-action-against-Isil-funding.html> accessed 1 March 2020.

also expressed concern that the largest share of individual private donations to terrorist groups such as IS comes from Qatar rather than Saudi Arabia, with its government failing to effectively enforce counter-terrorist financing laws prohibiting such fundraising.⁴² Diaspora communities and individual donors have thus provided lucrative funding sources, and weak controls allow such flows of money to terrorist causes to continue. Forging close associations with the diaspora communities in the USA was a particularly successful strategy for the charitable organisation Irish Northern Aid (NORAID).

3.2.2 Non-profit organisations

A) *Are NPOs vulnerable to abuse?*

The Financial Action Task Force, has identified several means by which NPOs are vulnerable to abuse by terrorist groups, such as; abuse through ‘false representation’; using NPOs as conduits for financing and in some cases to escape asset freeze measures; and the concealment of terrorist funds as they are diverted from legitimate channels to terrorist organisations through NPOs.⁴³

Firstly, terrorist organisations have posed as legitimate entities, as a ‘front’ organisation. Funds can then be legally raised, with unsuspecting donors (although in some cases donors may suspect or even be aware) contributing to a cause which may ultimately be distributed to support terrorism.⁴⁴

The charity NORAID, which was founded in 1970, was initially one of several organisations appealing to the Irish American community, but soon this charity became known as the sole representative of the Provisional IRA(PIRA) in the USA. From its origins in New York its influence spread rapidly to other

⁴² Robert Windrem, ‘Who’s funding ISIS? Wealthy Gulf “Angel Investors,” Officials say’ *NBC News* (New York, 21 September 2014) <https://www.nbcnews.com/storyline/isis-terror/who-s-funding-isis-wealthy-gulf-angel-investors-officials-say-n208006> accessed 1 March 2020.

⁴³ FATF, ‘International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation’ (Recommendation 8, FATF/OECD 2012 updated June 2019).

⁴⁴ FATF, ‘Risk of Terrorist Abuse in Non-profit Organisations’ (Typologies report, FATF/OECD 2014).

American cities with a significant Irish population. NORAID relied heavily on institutions with a substantial Irish membership or leadership, such as the New York Transport Workers Union, for support. Social events such as dances and pub socials became an accepted means of fund-raising and continued as such until the 1990's.⁴⁵ Funds were also raised by means of collecting tins being passed around, which has proved effective in situations where there is social pressure to give.⁴⁶

The US government reportedly did little to curtail these activities, and courts refused to cooperate with extradition requests from the UK for Irish nationals charged with terrorist offences. The political nature of the offence was cited as reason for denying extradition, casting doubt on the fairness of a trial in the UK.⁴⁷ The events of 9/11, however, changed the mood irrevocably toward the IRA, and the political authority of American Irish lobbyists: consequently, the flow of funds to NORAID diminished.⁴⁸

The Rahmah charitable organisation, designated in the US as a terrorist organisation, was found to be operating as a front for the terrorist group Al-Qaeda in the Arabian Peninsula (AQAP).⁴⁹ Al-Qaeda also used the concept of anonymity with respect to donations to its advantage to establish its own front charities. In some cases, the organisation itself existed to channel funds to terrorists. The Al-Wafa organisation is thought to have knowingly diverted funds to Al-Qaeda operatives at every level, including having control of its bank accounts.⁵⁰

⁴⁵ Brian Hanley, 'The Politics of NORAID' (2004) 19 *Irish Political Studies* 1,1-4.

⁴⁶ R Bell, 'The Confiscation, Forfeiture and Disruption of Terrorist Finances' (2003) 7(2) *Journal of Money Laundering Control* 105,106.

⁴⁷ Michael Levi, 'Combating the Financing of Terrorism' (2010) 50 *British Journal of Criminology* 650, 652.

⁴⁸ *ibid.*

⁴⁹ US Department of the Treasury, 'Treasury designates key facilitators and front company providing support to Al-Qa'ida in the Arabian Peninsula' Press Release 12 July 2016. <https://www.treasury.gov/press-center/press-releases/Pages/jl0673.aspx> 1 March 2020.

⁵⁰ 'National Commission on Terrorist Attacks Upon the United States (2004): Monograph on Terrorist Financing' Staff Report to The Commission Washington DC (9/11 Commission Report) 170-171.

A US court concluded that the Holy Land Foundation, which was the largest domestic Muslim charity before its enforced closure in 2001, had been established to support Hamas, a designated foreign terrorist organisation. It is likely that many donors were unaware of the eventual use to which their donations were made, but many office holders within the charity were convicted of providing material support to terrorists.⁵¹

There was also evidence presented in the trial in the US of Enaam Arnaout, CEO of the Benevolence International Foundation mentioned above, that illicit transfers of funds to extremists had taken place.⁵² Ridley concludes that this example, as well as several other cases suggested that NPOs had been exploited or even created for terrorist financing purposes prior to 9/11. This finding led to the recognition that NPOs were at particular risk, and therefore required greater scrutiny and regulatory oversight.⁵³

The second means of abuse identified is the exploitation of NPOs as conduits for terrorist financing or circumventing asset-freeze measures. This may arise when for example, extremists are recruited and funded to carry out terrorist acts.⁵⁴ The Pakistan-based NPO the Al-Rehmat Trust was designated in the US as a terrorist organisation having found to be providing financial and logistical support to foreign fighters and supporting the recruitment of students to commit terrorist acts in Afghanistan. The group Jaish-e Mohammed (JEM) was designated by the UN as a terrorist group and banned in Pakistan but relied on the Al-Rehmat Trust to continue to finance its activities.⁵⁵

⁵¹ US Department of Justice, 'Federal Judge Hands down sentences in Holy Land Foundation Case' Press Release 27 May 2009 <https://www.justice.gov/opa/pr/federal-judge-hands-down-sentences-holy-land-foundation-case> accessed 1 March 2020.

⁵² US Department of the Treasury, 'Treasury Designates Benevolence International Foundation and Associated Entities as Financiers of Terrorism' Press Release 19 November 2002 <https://www.treasury.gov/press-center/press-releases/Pages/po3632.aspx> accessed 1 March 2020.

⁵³ Nicholas Ridley, *Terrorist Financing: The Failure of Counter Measures* (Edward Elgar 2012) 68.

⁵⁴ Clive Walker, 'Terrorism Financing and the Governance of Charities' in King, Walker and Gurulé (eds), *The Palgrave Handbook of Criminal and Terrorism Financing Law* (Palgrave 2018) 1087.

⁵⁵ US Department of the Treasury, 'US Treasury Targets Pakistan-based Organisations Lashkar-E Tayyiba and Jaish-E Mohamed', Press release 11 April 2010 <https://www.treasury.gov/press-center/press-releases/Pages/tg944.aspx> accessed 1 March 2020.

The third means identified, the diversion of funds from legitimate channels was highlighted as the most dominant method of financial abuse of NPOs by the FATF in its 2014 typologies report.⁵⁶ Funds were diverted at various stages as the NPOs conducted their business operations, for example at the collection stage where funds raised for charitable purposes may be syphoned off, or at the stage at which funds are transferred to the eventual beneficiaries. Funds were diverted by individuals within the organisation, but also less commonly, by third parties, for example by foreign partners associated with the organisation or external fundraisers.⁵⁷ The principal determinant of risk was based on the value of the individual NPO's resources to the terrorists, as well as the proximity to an 'active terrorist threat'. This threat was considered to be substantial where the purpose was to provide 'service' activities, for example those involving housing and health care.⁵⁸

Individuals aiming to offer their services as foreign terrorist fighters alleging an association with a charitable organisation would facilitate their passage to Syria, were convicted in the US for 'conspiring to provide material support for terrorism'.⁵⁹ The perception was that charity workers could move with less rigorous scrutiny and as such false representation may provide a useful cover for potential foreign terrorist fighters. This also demonstrates that some may seek to exploit charitable organisations for purposes other than gaining access to funds. A further example is provided in the case of Syed Hoque in the UK, although convicted of terrorist financing offences demonstrating the intention to abuse the charity to transport funds, he was also provided with an open-ended letter of credential from the charity for which he volunteered, with the intention of gaining permission to travel freely, purportedly on the business of the charity,⁶⁰ thus also abusing the charity for non-financial gain.

⁵⁶ FATF, 'Risk of Terrorist Abuse in Non-profit Organisations' (FATF/OECD 2014).

⁵⁷ *ibid* 37-38.

⁵⁸ *ibid*.

⁵⁹ US Department of Justice, 'Raleigh men sentenced for conspiracy to provide material support for terrorism' (Press release, 5 July 2016) <https://www.justice.gov/usao-ednc/pr/raleigh-men-sentenced-conspiracy-provide-material-support-terrorist> accessed 1 March 2020.

⁶⁰ Charity Commission, 'Regulator Publishes Reports of Cases Involving Individuals Convicted of Terrorist Offences' (Press release, 16 October 2017).

Kuwait has been described as the “epicentre of fundraising for terrorist groups in Syria” as charity fundraisers exploiting the generosity of unwitting donors in the name of humanitarian aid, diverted funds to extremist groups.⁶¹

There are a number of specific characteristics, relating to the unique environment in which many charities operate, identified as a cause for concern: access to substantial funding sources; regularly operating on a cash-intensive basis; a high level of public trust; a presence in high-risk jurisdictions; the use of alternative financial instruments; and in many cases minimal regulatory oversight.⁶²

Other vulnerabilities identified by the Charity Commission with respect to domestic charities, which could equally apply to NPOs in other jurisdictions, in that they are relatively easy to set up and may have a limited number of unsupervised individuals playing a pivotal role in the administration of the organisation.⁶³ There are often complex money flows involved, originating from multiple donors, some of whom may donate anonymously, and may derive from untraceable sources. Funds may be transferred to other jurisdictions with less stringent financial sector regulation and may involve currency exchange and pass through partner organisations or branches which are not directly supervised by the Trustees. This adds another layer of complexity and opportunity for interception. The social network often created by charitable endeavour, which may attract a diversity of people in legitimate association, could also provide a social network which could be infiltrated by those seeking to fund terrorism.⁶⁴

⁶¹ US Treasury Department, ‘Remarks by David Cohen before the Centre for a New American Security on “Confronting New Threats in Terrorist Financing”’ (Press release, 4 March 2014) <https://www.treasury.gov/press-center/press-releases/Pages/jl2308.aspx> accessed 1 March 2020.

⁶² FATF, ‘International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation’ (FATF/OECD 2012 updated 2019) (FATF Recommendations).

⁶³ Charity Commission, ‘Compliance Toolkit: Protecting Charities from Harm’ December 2012 Chapter 1 Module 3 1-2.

⁶⁴ *ibid.*

This combination of factors contributes to an environment of heightened risk, and many jurisdictions have been ill-equipped to identify the possible threats inherent in such an environment, or to provide adequate regulatory oversight.⁶⁵ The charitable purpose of NPOs operating in areas of political instability often places them in a vulnerable position. Some contact and involvement with political organisations may be inevitable, and even justified in these circumstances, especially in the provision of humanitarian relief. This increases their vulnerability though and may expose them to the risk of contravening counter-terrorist finance regulation.⁶⁶ Some of the practical implications for charities working within such high-risk environments with respect to regulatory compliance will be explored in Chapter Six.

Shell charities too have been problematic, as they carry out minimal activity, or none at all, such organisations exist to “frustrate private and public law enforcement efforts through misdirection and obfuscation.”⁶⁷ Such entities may allude to being legally registered, or may in fact have legally registered with the appropriate authority as charitable organisations, which may bestow an air of legitimacy. Barr suggests, however, that the risk of shell charities being used as a conduit for terrorist financing, although a real possibility, is no more of a risk than that presented by entities constituted as shell corporations.⁶⁸

Whereas there is undoubtedly a potential for abuse of the sector, the actual extent to which such organisations have been abused for terrorist financing purposes has been the subject of much debate. There are no dependable figures available on which to gauge the extent of terrorism funding overall, nor on the contribution that may come from the NPO sector. Many consider though that this contribution is likely to be minimal in comparison with the sector’s turnover.⁶⁹

⁶⁵ Emile van der Does de Willebois, ‘Non-profit Organisations and the Combating of Terrorism Financing: A Proportionate Response’ (Working Paper No.208, The World Bank 2010) 7.

⁶⁶ Kenneth Dibble, ‘The Funding of Terrorism Through Charities’ (RUSI 14 November 2007)

⁶⁷ Warren Barr, ‘Shell Charities and terrorist financing: A sledgehammer to crack a shell?’ (2017) 31 *Trust Law International* 1,2.

⁶⁸ *ibid* 9.

⁶⁹ Van der Does de Willebois (n 65).

Nevertheless, in 2014, the FATF noted in its typology report the continuing exploitation of the sector over a decade after it had been raised as a major concern. Although this represented a low probability risk, the impact was of a much higher magnitude; for the victims of terrorism and from the loss of benefit to the intended recipients.⁷⁰ The strong wording of the report, describing such exploitation as ‘a particularly egregious form of abuse that fundamentally undermines public trust in the NPO sector’ suggests that their perception of the problem remained unchanged.⁷¹ This perception of risk has however been modified recently following a review in 2016, but the enduring message continues to suggest that NPOs in certain circumstances remain vulnerable to terrorist financing abuse.⁷²

B) *Muslim NPOs-a particularly vulnerable sector?*

According to Howell, the shadow of suspicion fell upon certain elements of civil society and not others in the post 9/11 era. NPOs working in the Middle East, humanitarian agencies operating in conflict zones, and in particular Muslim NPOs and communities became subject to greater scrutiny. Such entities were viewed through a ‘prism of security’ both in the public perception and the political arena.⁷³

It is estimated that faith-based organisations, in particular Muslim, contributed 15-16% of all humanitarian assistance channelled through NPOs globally.⁷⁴ The US authorities rapidly closed down several Muslim charities in the aftermath of 9/11 and many claim that the focus on this section of civil society is unfair, in unduly targeting the sector. For example, the US Treasury department list of

⁷⁰ FATF (n 56).

⁷¹ *ibid.*

⁷² FATF Recommendations (n 62) 11.

⁷³ Jude Howell, ‘Commentary: Crises, Opportunities and the Elephant in the Room’ (2011) 7 *Journal of Civil Society* 265, 266-267.

⁷⁴ Chloe Stirk, ‘An Act of Faith: Humanitarian Financing and Zakat’ (Briefing paper, Global Humanitarian Assistance 2015) https://reliefweb.int/sites/reliefweb.int/files/resources/EMBARGOED%2026_03_2015%20Zakat_report_V9a.pdf accessed 1 March 2020.

specially designated global terrorists feature Muslim NPOs, although others provide humanitarian aid to similar geographical areas and are exposed to similar levels of threat but are not similarly listed.⁷⁵

This section of civil society therefore has been considered to display particular vulnerabilities to abuse by those seeking to fund terrorist activities. The following section seeks to identify why this may be. The risk of financing jihadi terrorism through charitable organisations is considered to be augmented by factors such as extreme teachings of Wahhabist clerics and hijacking of charities by terrorist groups,⁷⁶ the prevalence of Zakat, the religious duty of charitable giving, and the proximity of many charities to conflict zones in areas of political instability, thus increasing their vulnerability, as illustrated below.

Kaplan et al offer a historical perspective on the Saudi Kingdom's relationship with terrorism and offer some insight as to why a nation would fund a terrorist movement that now terrorises even its own society, and the relationship between some Saudi charities and the financing of extremism.⁷⁷ The Khomeini revolution in Iran, Soviet invasion of Afghanistan and the takeover by militants of the Grand Mosque in Mecca in 1979 had a considerable impact on the Saudi kingdom. In fear that radical elements in Tehran would assert their own leadership and become a dominating force in the Middle East and the rest of the Muslim world, Saudis began spending on overseas aid.⁷⁸ Large global charities were established in the 1960's and 1970's for the purpose of spreading Wahhabist theology, and Sunni extremist groups worldwide were supported by Saudi Arabian oil money. Saudi Arabia's quasi-official charities starting in the late 1980's began funding the jihad movement. Such charities were closely affiliated to the ruling elite and to organisations such as the Muslim World League.⁷⁹

⁷⁵ J Howell, 'The Global War on Terror, Development and Civil Society' in Fowler and Malunga (eds) (n 19) 45.

⁷⁶ David Kaplan, Monica Ekman and Aamir Latif, 'The Saudi Connection' (2003) 135 (21) US News and World Report 18.

⁷⁷ *ibid* 18-32.

⁷⁸ *ibid* 19.

⁷⁹ *ibid* 4.

The Al Haramain Foundation, perhaps the most influential organisation spreading Islamic fundamentalism funded 3,000 Wahhabi missions worldwide; mosques, schools and colleges in both Islamic and non-Islamic countries.⁸⁰ The charity, funded by wealthy individual donors as well as the Saudi government, was described by a former Al-Qaeda representative Omar al Faruq as being the funding source of all operations in Indonesia.⁸¹

An understanding of the philanthropic structures that underpin Muslim societies may provide an insight into how terrorist groups have been able to abuse such structures and provide an avenue for terrorist financing. Charitable and philanthropic structures are not only important in economic terms, but they are also socially, culturally and politically institutionalised in Muslim civic societies.⁸² Central to this is the Qur'an, considered by Muslims to be the source of all knowledge and 'Guidance to mankind'⁸³: the divine word of God, literally revealed to the prophet Mohamed through the agency of the angel Gabriel, in a way that no other religious document purports to have been.⁸⁴

The obligatory nature of zakat, the Islamic concept of charitable giving, and one of Islam's five pillars, is decreed in the Qur'an. Enshrined in this system of social justice is the inherent right for the poor and needy to support from wealthier members of society, who are obliged to donate a proportion of their wealth.⁸⁵ The Qur'an extols the virtues of giving anonymously to the poor and in private,⁸⁶ it is therefore common practice for Muslims to donate through Islamic charities or other agents. Both Zakat and sadaqah, a voluntary offering for the benefit of another, are regarded as personal religious responsibilities, and as

⁸⁰ Victor Comras, 'Al Qaeda Finances and Funding of Affiliated Groups' in Giraldo and Trinkunas (eds) (n 17) 121.

⁸¹ Brisard (n 39) 18.

⁸² Nina Crimm, 'The Moral Hazard of Anti-terrorism Financing Measures: A Potential to Compromise Civil Societies and National Interests' (2008) 43 Wake Forest Law Review 577, 579

⁸³ *The Qur'an* (Penguin Books 1968) 2:2.

⁸⁴ Fazlur Rahman, *Islam and Modernity: Transformation of an Intellectual Tradition* (University of Chicago Press 1984) 2.

⁸⁵ Zakat Foundation of America, 'What is Zakat?' <https://www.zakat.org/en/zakat-resource-center/zakat-social-justice/> accessed 1 March 2020.

⁸⁶ *The Qur'an* (n 83) 2:271.

such the oversight of these donations, by some governments, has been minimal or non-existent, with donations remaining for the most part anonymous.⁸⁷

This raises the question of whether there is conflict between the requirement for anonymity with respect to donations and the requirement for transparency of financial flows which is a central component of the counter-terrorist finance regulation, as discussed in the next chapter.⁸⁸ This theme is also explored further in Chapter Six in the discussion with participants from faith charities.

Although there is scant information available with respect to the global figure involved, it is estimated that between \$20 billion and \$200 billion is given annually in zakat across the Muslim world.⁸⁹ Many zakat donations are made outside any traceable system which makes any meaningful estimate difficult. In the US, commentators have noted the total absence of any reliable data on zakat donations from the Muslim American population.⁹⁰ A UN report from the Office for the Co-Ordination of Humanitarian Affairs (UNOCHA) however put the figure between \$200 billion and \$1 trillion,⁹¹ with Saudi Arabia alone generating \$9 billion per year.⁹² In the UK May notes that zakat donations amount to millions of pounds.⁹³ Whilst financial data with respect to donations to mosques and charities is readily available, as such institutions are required to file accounts with the Charity Commission, the full extent of zakat and Sadaqah would be impossible to gauge as many Muslims fulfil their charitable obligations by sending money to relatives in the form of remittances.⁹⁴

⁸⁷ Comras (n 80) 119.

⁸⁸ Ondrej Beranek, 'The (Mis)use of Islamic charity: Past, Present and Future' (2010)78 *Oriental Archive* https://www.academia.edu/3330702/The_Mis_use_of_Islamic_Charity_Past_Present_and_Future accessed 1 March 2020.

⁸⁹ Ian Wilhelm, 'Muslim Philanthropists Discuss Ways to Raise Profile of Islamic Giving' (2008) 20 (12) *The Chronicle of Philanthropy* 14.

⁹⁰ Laila Al-Marayati, 'American Muslim Charities: Easy Targets in the War on Terror' (2005) 25 *Pace Law Review*, 321.

⁹¹ Fadi Itani, 'The Muslim Zakat: A Vision of the 'Big Society'' *New Statesman* (London, 11 August 2012) <https://www.newstatesman.com/blogs/politics/2012/08/muslim-zakat-vision-big-society> accessed 1 March 2020.

⁹² Alex Alexiev, 'Islamic Finance or Financing Islamism' (Occasional Paper series No.27, The Center For Security policy October 2007).

⁹³ Samantha May, 'The Best of Deeds: The practice of zakat in the UK' (2019) 61(2) *Journal of Church and State* 200, 204.

⁹⁴ *ibid.*

The institution of Zakat is enshrined in law in 16 out of the 40 countries that have a Muslim majority. Where zakat is a mandatory legal requirement such as in Pakistan and Saudi Arabia, the contributions are collected by the state.⁹⁵

In countries such as United Arab Emirates and Saudi Arabia where there are no established systems of income taxation, the system of Zakat provides the principle funding-source for many of the domestic charitable organisations.⁹⁶

There is therefore huge potential for enhancing social welfare, but this system of anonymous, often unregulated charitable giving can also be open to abuse by terrorist organisations and has come under intense scrutiny, in the US in particular, in the post 9/11 period.

4. CRIMINAL AND LEGAL ACTIVITY AND THE RELATIONSHIP WITH TERRORIST FINANCE

Any acquisitive crime can be used to fund terrorism. Funds derived from criminal activity can avoid legitimate regulated business channels with the associated risk of detection. They could be used to purchase goods (forged passports and weapons, for example) as well as services illicitly, in order to perpetrate terrorist activity.⁹⁷ Terrorists may also diversify their risk with multiple types of criminal activity and intermingle criminal with legal activities. Some examples of these will be discussed in this section to emphasise the breadth of fund-raising activities from both legal and illegal activities, as well as providing comment on the diverse socio-economic background of individuals involved in terrorism.

4.1 Criminal activity and a relationship with terrorism

NPOs may operate in an environment in which both criminals and terrorists have a close relationship. Furthermore, there is evidence that NPOs have been

⁹⁵ Russell Powell, 'Zakat: Drawing Insights for legal theory and economic policy from Islamic jurisprudence' (2009) 7 University of Pittsburgh Tax Review, 43, 58-59.

⁹⁶ Comras (n 80) 119.

⁹⁷ John Picarelli and Louise Shelley, 'Organized Crime and Terrorism' in Giraldo and Trinkunas (eds) (n 17) 40-41.

exploited by criminal groups as well as terrorist groups, with opportunities for fraudulent activities afforded, for example, by the operations of humanitarian NPOs responding to natural disasters, such as Hurricane Katrina in the USA.⁹⁸

Giraldo et al point to the many Marxist-Leninist groups who, throughout the 1960's and 70's, resorted to criminal activities such as extortion, robbery and kidnapping as a source of funds. The Palestine Liberation Organisation (PLO), although recipients of significant state sponsorship, diversified their income streams before the end of the cold war to reduce reliance on their unpredictable benefactors. Other groups too, such as Hezbollah, have cultivated multiple income streams, regardless of the levels of state funding.⁹⁹

Many in the 1990's forecast a convergence of terrorism and transnational organised crime although it was widely believed that the difference in the motivation of the two groups (political versus economic) would help retain their distinct identity. Shelley and Picarelli however, maintain that a closer form of interaction has emerged. Terrorist and criminal groups have borrowed each other's methods (shared appropriation) and have used the specialist services of each other. For example, a terrorist group may outsource the forging of documents to a criminal specialist in the field.¹⁰⁰ There may also be a significant crossover between criminal groups and terrorist groups. Raufer, French criminologist and Balkans expert, maintains that the Albanian mafia and the Kosovo Liberation Army (KLA) were one and the same, they are '...liberation fighters by day and sell heroin by night or vice versa'.¹⁰¹

Kidnap for ransom (KFR) may represent the most important source of terrorist funding today.¹⁰² Partly attributed to the diminution of other terrorist financing

⁹⁸ Nicholas Ridley, *Terrorist Financing: The Failure of Counter Measures* (Edward Elgar 2012) 67.

⁹⁹ Jean Giraldo and Harold Trinkunas, 'The Political Economy of Terrorism Financing' in Giraldo and Trinkunas (eds) (n 17) 10.

¹⁰⁰ Louise Shelley and John Picarelli, 'Methods and Motives: Exploring the links Between Transnational Organised Crime and International Terrorism' (2005) 9 (1) *Trends in Organised Crime* 52, 53.

¹⁰¹ Cited in Ridley (n 98) 48.

¹⁰² US Department of the Treasury, 'Remarks of Under-secretary David Cohen at Chatham House on "Kidnapping for Ransom: The Growing Terrorist Financing Challenge"' (Press Release, 5

sources such as state sponsorship and contributions from wealthy individual donors, and as a result of successful counter-terrorist finance policies.¹⁰³ This profitable source of financing requires little specialist knowledge, low entry costs and virtually unlimited opportunities.¹⁰⁴ Victims included aid workers, foreign tourists and diplomats. In the four months to May 2018 for example, 36 aid workers were abducted in South Sudan, and in some cases accused of spying.¹⁰⁵ Six aid workers in the Central African Republic and neighbouring DRC were reportedly abducted for the purpose of terrorist financing in 2018 with many more, a figure close to 50%, still missing at the time of the report in April 2019.¹⁰⁶ This underlines the dangers for NPOs operating in unstable environments; the potential for contravening CTF regulation in this respect will be explored in Chapter Four.

Low-level crime linked to terrorism, with individuals moving seamlessly between is a phenomenon described as the 'new crime-terror nexus,' however, it is also argued that terrorists have long been regarded as predominantly middle class with no links to criminality; the profiles of 9/11 bombers attest to this, as many were university students.¹⁰⁷ Some commentators believe that this no longer holds true though, and the new crime-terror nexus is characterised by criminals and terrorists having contact within the same section of society, for example in prisons; but also becoming increasingly apparent is the convergence of crime and terrorism in European ghettos, amongst the poor and marginalised. A recent report concluded that around 40% of European terrorist plots have been financed by low level crime, at least in part, and the increased

October 2012) 3-4 <https://www.treasury.gov/press-center/press-releases/pages/tg1726.aspx> accessed 1 March 2020.

¹⁰³ Yvonne Dutton, 'Kidnap and Terrorism Financing' in King, Walker and Gurulé (eds), *The Palgrave Handbook of Criminal and Terrorism Financing Law* (Palgrave 2018).

¹⁰⁴ Picarelli and Shelley (n 97) 47.

¹⁰⁵ Insecurity Insight, 'Aid Workers Kidnapped 2018' (11 April 2019) <https://reliefweb.int/sites/reliefweb.int/files/resources/Aid-Workers-Kidnapped-2018.pdf> accessed 1 March 2020.

¹⁰⁶ *ibid.*

¹⁰⁷ Rajan Basra, Peter Neumann and Claudia Brunner, 'Criminal Pasts, Terrorist futures: European Jihadists and the New Crime-Terror Nexus' (International Centre for the Study of Radicalisation (ICSR) 11 October 2016).

incidence of this form of criminality suggests that this means of financing terrorism is likely only to increase accordingly.¹⁰⁸

Reports of the recent terrorist attacks in Sri Lanka however, make clear that terrorists involved in suicide bombings, in this case well-educated middle class Sri Lankans, come from a wide variety of backgrounds.¹⁰⁹ Thus, whether funds derive from low-level or more sophisticated criminal sources, the relationship between criminals and terrorists is often one of cooperation and collaboration who may also interact within the operating environment of NPOs, especially in geographical areas of political instability.

4.2 Financing terrorism through legal activity

Some terrorist groups also carry out completely legitimate activities as a means of raising funds; legitimate fronts to help conceal the origins of money used to finance terrorism. Osama Bin Laden reportedly built up, and operated, a diverse business empire in the Sudan during his time there in the 1990's. Such businesses included the cultivation of sesame and peanuts, honey production, a construction company and numerous trading companies.¹¹⁰ Al Barakaat's financial services and telecommunications empire also supplied funds for al-Qaeda.¹¹¹

The 2015 report on financing of European Jihadi cells noted an increase in self-financing through legal activities within these groups; such legal funding streams having the advantage of attracting less attention than criminal activity,¹¹² as well as reducing the financial burden on organisations that may be

¹⁰⁸ *ibid* 4.

¹⁰⁹ 'Sri Lanka Attacks: What we Know and Don't Know' *The New York Times* (New York, 24 April 2019) <https://www.nytimes.com/2019/04/24/world/asia/sri-lanka-easter-bombing-attacks.html?action=click&module=RelatedCoverage&pgtype=Article®ion=Footer> accessed 1 March 2020.

¹¹⁰ Jamal Al Fadl Testimony transcript, 'USA v Usama bin Laden' 5 February 2001 <https://cryptome.org/usa-v-ubl-02.htm> accessed 1 March 2020.

¹¹¹ Jonathan Winer and Trifin Roule, 'Fighting Terrorist Finance' (2002) 44 *Survival* 87,89

¹¹² Oftedal (n 7) 7.

providing support.¹¹³

Some self-financing cells have operated with a high degree of professionalism, taken precautionary security measures to avoid detection and, as such, employed methods of financing attacks which would have virtually no detectable relationship to either terrorism or criminal activity.¹¹⁴ This underlines the difficulty for law enforcement agencies when financial activity is not inherently suspicious. Perhaps even more so when perpetrators are well-educated, employed, and use counter-surveillance measures to avoid drawing unwanted attention to themselves, as well as having no previous discernible links to terrorism or criminality.

A recent Australian TF risk assessment concluded that the majority of fund-raising for terrorist purposes derived from legitimate sources in 5 of the 6 countries examined,¹¹⁵ which further demonstrates that financing from legal sources is increasingly prevalent.

5. THE DISSEMINATION OF TERRORIST FUNDS

As well as raising funds, terrorists often need to transfer funds, both to deliver funds to where they are needed to support acts of terrorism or for a myriad of possible organisational requirements, as outlined previously.

Terrorist groups have taken advantage of the forces of globalisation; the advances in communication technologies, the ease at which money can be electronically transferred, and more relaxed border-crossings.¹¹⁶ As such, opportunities arise to facilitate the movement of funds in an increasingly sophisticated way, and to obfuscate their origin in order to escape detection.

¹¹³ Napoleoni (n 5) 17.

¹¹⁴ For example, 'The Doctor cell' case study in Oftedal (n 7) 31.

¹¹⁵ Australian Transaction Reports and Analysis Centre (Austrac), 'Regional Risk Assessment on Terrorism Financing: South-east Asia and Australia' (2016).

¹¹⁶ Thomas Biersteker, 'Targeting Terrorist Finances; The New Challenges of Financial Market Globalization' in Ken Booth and Tim Dunne (eds), *Worlds in Collision: Terror and the Future of Global Order* (Palgrave Macmillan 2002) 75.

A variety of means therefore, with which to move funds around the world is available, including the use of credit and debit cards, travellers' cheques, wire transfers and cash. Terrorists have exploited well-regulated financial systems as well as the often-unregulated informal value transfer systems and taken advantage of more opaque means of storing value offered by commodities such as diamonds and gold. NPOs globally may use some of the same means of transferring funds as both terrorists and criminals. They use, for example, both formal and informal banking systems as well as cash, depending on the environment in which they are operating. Some of these means of disseminating funds also present a heightened risk of being used to move funds to terrorist organisations.

5.1 Formal banking systems

The FATF has highlighted the potential vulnerability of all financial institutions to facilitate illicit transfer of terrorist funds.¹¹⁷ These institutions may also unwittingly enable terrorists to open accounts to store funds prior to their transfer or for use, for example, to purchase equipment for terrorist acts. Dilloway outlines the modus operandi of terrorist groups from North Africa in the UK, who were able to open numerous bank accounts by using multiple fake EU identity documents. Accounts were typically maintained for a period to give the appearance of legitimacy and establish a credit limit. Large amounts of cash could then be accumulated in a short period using credit cards, cash withdrawals, unsecured loans and purchases by cheque. The latter could be returned for a cash refund before the cheque has cleared or goods sold on to raise cash. The fictitious accountholder could then default on the loans and vanish.¹¹⁸

¹¹⁷ FATF, 'Emerging Terrorist Financing Risks' (FATF/OECD 2015).

¹¹⁸ Simon Dilloway, 'The Current state of Affairs: 7/7 Attack-London Bombings' (Lopham Consultancy) <http://www.lophamconsultancy.co.uk/London%20Bombings.pdf> accessed 1 March 2020.

In the analysis of the 9/11 terrorist attack it became evident that funds were transferred via wire transfer, debit card transactions, cheques and cash withdrawals through banks and formal regulated remittance services.¹¹⁹ It was also discovered that one of the transfers had prompted a suspicious activity report (SAR), prior to the terrorist attack, which was neither evaluated in a timely manner nor was it investigated further.¹²⁰ Whilst some maintain that with sufficient coordination of the intelligence available the plot could have been frustrated,¹²¹ others doubt whether the counter-terrorist finance regulation introduced as a reaction to 9/11 could have prevented it; as Ryder points out this legislation did not prevent the 2013 terrorist attack at the Boston Marathon.¹²²

Donohue also maintains that 'SARs did not discover, nor should they have discovered, nor would they now discover any of the financial activity in which the September 11 hijackers were engaged'.¹²³ Thus, due to the scale of operations of international banking sector, terrorist funds can mingle with normal financial activity and be indistinguishable from legitimate transactions.¹²⁴ The requirement though for banks to act as 'financial police' and to report activity which may alert authorities to impending terrorist acts has resulted in a considerable administrative burden, which will be discussed in greater depth in Chapter Four.¹²⁵

International correspondent banking arrangements can also be vulnerable to terrorist exploitation; particularly useful when normal banking arrangements are not an option. A correspondent bank may provide a wide range of services to another bank (the respondent bank) including cheque clearing and foreign exchange services where, for example, the respondent bank has no established

¹¹⁹ 9/11 Commission Report (n 50)13.

¹²⁰ Phil Williams, 'Warning Indicators' in Giraldo and Trinkunas (eds) (n 17) 86.

¹²¹ Louise Amoore and Marieke de Goede, 'Transactions after 9/11: the banal face of the pre-emptive strike' (2008) 33 (2) *Transactions of the Institute of British Geographers* 173,174.

¹²² Nicholas Ryder, *The Financial War on Terrorism: A Review of Counter-terrorist Financing Strategies since 2001* (Routledge 2015) 87-89.

¹²³ Donohue (n 3) 347.

¹²⁴ FATF, *Emerging Terrorist Financing Risks* (n 117) 21.

¹²⁵ S.5.2.2.

branches. The correspondent bank therefore acts as agent.¹²⁶ Criminals and terrorists often select banks in jurisdictions where there is lax regulation, for example those located on the numerous small Caribbean and Pacific islands and thus gain access to the more regulated banking sector. When large numbers of accounts, both individual and institutional, are merged through a network of banks, monies derived from criminal sources can co-mingle with legitimate accounts of corresponding banks worldwide, as occurred in the Citibank cases of 2001.¹²⁷

Offshore banks too have been implicated in terrorist financing. Investigations into a terrorist cell operating from a mosque in Milan revealed that monies received in Euros which originated from Arab sponsors had passed through a British offshore account.¹²⁸ Offshore accounts, wire transfers and correspondent accounts are all legal instruments, which can potentially be used by terrorists without arousing suspicion. Furthermore, banks may not be able to distinguish between terrorist transactions and legitimate ones if the money involved is consistent with a customer's profile.

In the post 9/11 period Islamic banking and financial institutions came under close scrutiny as providing possible avenues for terrorist financing. The Gulf States as centres of scholarship and pioneers in Islamic banking are respected and highly valued within other Arab communities. As such there was considerable resentment at the intense interest shown by various law enforcement agencies in the vulnerabilities of the banking system and this was construed as an unnecessary intrusion and targeting of Arab jurisdictions.¹²⁹

The religious rationale for Islamic banking for some is more important than any societal economic benefits that may accrue (for example a more egalitarian

¹²⁶ Valpy FitzGerald, 'Global Financial Information, Compliance, Incentives and Terrorist Funding' (2004) 20 (2) *European Journal of Political Economy* 387, 390.

¹²⁷ Tim Golden, 'The Citibank Connection: Real Money, Shadowy banks' *The New York Times* (New York, 27 February 2001).

¹²⁸ Napoleoni (n 5) 17.

¹²⁹ Nicholas Ridley and Dean Alexander, 'Combating Terrorist Financing in the First Decade of the Twenty-First Century' (2011) 15 (1) *Journal of Money Laundering Control* 38, 49.

society), the reassertion of Muslim identity and religious authority in a field that is usually associated with the secular West.¹³⁰ As far as supervision is concerned, the Islamic Financial Services Board (IFSB) is responsible for the oversight of Islamic Financial institutions. Their authority and powers of enforcement, according to Ridley appear negligible and it is doubtful whether any guidelines issued by the Board would have universal recognition.¹³¹ The Sharia committees enjoy almost autonomous status and this, combined with the general lack of regulation and oversight would allow opportunities for funds earmarked for charitable purposes to be diverted to terrorist organisations. Islamic banks have been described as the 'lifeline of Islamist insurgency'.¹³²

The expansion of Islamic finance has been rapid in recent years. In the case of Malaysia, since 1960, becoming one of the main proponents, together with the Persian Gulf states, with most Muslim majority countries now having some degree of Muslim finance available.¹³³ The third main area of expansion has been in the Non-Muslim world, particularly in the financial centre of London with the development of Islamic Investment instruments.¹³⁴ A recent IMF working paper suggested that whilst the ML/TF risks associated with conventional finance were well understood, this was not the case with Islamic finance. There was no indication that the risks were higher in this specific sector, but there had been no meaningful study of the potential risks, neither had individual countries conducted a risk assessment of the specific features of Islamic finance.¹³⁵ This vulnerability, and the applicability of international standards to Islamic finance will be discussed further in the next chapter.

¹³⁰ Timur Kuran, 'Islam and Mammon: The Economic Predicaments of Islamism' (Princeton University Press 2004) 58.

¹³¹ Nicholas Ridley, 'Islamic Financial Institutions and Potential Vulnerability to Money Laundering and Illicit Transfer of Terrorist Funds' Study commissioned to London Metropolitan University by the Institute of Security Analysis and Strategic Networking (Basle 2000).

¹³² Napoleoni (n 31) 121.

¹³³ Ibrahim Abraham, 'Riba and Recognition: Religion Finance and Multiculturalism' (Essay, from the Australian Association for the Study of Religions Conference 2008) 41

¹³⁴ *ibid.*

¹³⁵ Nadim Kyriakos-Saad, Manuel Vasquez, Chady E Khoury and others, 'Islamic Finance and Anti-money Laundering and Combating the Financing of Terrorism' (Working Paper WP/16/42 29, IMF February 2016).

5.2 Money Service Businesses (MSBs)

MSBs provide a vital service for many without recourse to the formal banking sector to send money, cash cheques and other stored value instruments, and to exchange currency. These businesses vary in size from large international companies to small convenience stores offering a cheque-cashing service.¹³⁶

Non-bank institutions can settle their transactions either through the banking system or by other means, for example in cash.¹³⁷ Due to the nature of a MSB, which is regarded as a subset of the financial services provided by banks, it is considered to present a greater risk to a country's financial system as a potential conduit for terrorist financing. In the UK for example the risk has been persistently assessed as high.¹³⁸ In Canada, whilst recognising that all types of MSBs could be misused, two categories in particular were assessed as very high risk for ML and TF; 'full service' MSBs, which have global operations, and small independent businesses which may have links to IVTS such as Hawala, and to places where there is no formal banking system, and may send funds to areas where there is known terrorist activity.¹³⁹

Some of the vulnerabilities of MSBs relate to certain characteristics which include the simplicity of use for the customer and the less stringent requirements for identification than banks. Furthermore, MSBs may not maintain a long-term relationship with their customers and the contact for a single transaction may be very brief. Transactions are often cash-based and may involve payments to unstable geographical areas, all of which creates an

¹³⁶ Joint Money Laundering Steering Group (JMLSG), 'Prevention of Money Laundering/Combating Terrorist-Financing: Guidance for the UK Financial Sector' (21 December 2017 and updated 2019) 20.

¹³⁷ FATF, 'Guidance for a Risk-based Approach for Money or Value Transfer Services' (FATF/OECD February 2016).

¹³⁸ HM Treasury and Home Office, 'National Risk Assessment of Money Laundering and Terrorist Financing' (October 2017) 69.

¹³⁹ Department of Finance Canada, 'Assessment of Inherent Risks of Money Laundering and Terrorist Financing in Canada' 2015

environment of risk that the process may be used for terrorist financing purposes.¹⁴⁰

The Australian financial intelligence agency AUSTRAC reportedly cancelled the registration of the MSB Bisotel Rieh due to fears that funds were being transferred to terrorist organisations. Apart from findings of serious failures in record keeping, Austrac estimated that \$20 million could have been sent to Turkey and Lebanon for the purpose of financing terrorism.¹⁴¹ Austrac reportedly warned that funds including those ostensibly raised for charitable purposes in small and moderate amounts were co-mingled with legitimate funds, a practice that was emerging as 'the most significant terrorism funding channel in Australia and the most difficult to monitor'.¹⁴²

5.3 Informal value transfer systems (IVTS)

Passas, in his report to The US government identified two types of value which may be transferred; the value of funds in the form of physical currency and the value of 'stored' items, which may provide a useful vehicle for terrorists to transfer funds.¹⁴³

The first type, informal funds transfer systems, were established as a vehicle for settling accounts within local communities. Such systems developed in China, known there as 'fei-ch'ien', and elsewhere as phei kwan (Thailand), hundi (India) and hawala in the Middle East. The latter is most frequently referred to in the context of terrorist financing. Their initial growth can be attributed to their use in facilitating trade before the advent of formal banking systems.¹⁴⁴

¹⁴⁰ JMLSG (n 136) 21.

¹⁴¹ Rachel Olding, 'Khaled Sharrouf-linked Business to be Permanently Shut' *Sydney Morning Herald* (Sydney, 30 September 2014) <https://www.smh.com.au/national/khaled-sharrouflinked-business-to-be-permanently-shut-20140930-10o3l3.html> accessed 1 March 2020.

¹⁴² *ibid.*

¹⁴³ Nikos Passas, 'Informal Value Transfer Systems, Terrorism and Money Laundering' (Report to the US National Institute of Justice 2005) <https://www.ncjrs.gov/pdffiles1/nij/grants/208301.pdf> accessed 1 March 2020.

¹⁴⁴ The Financial Sector Vice-Presidency, 'Informal Funds Transfer Systems: An Analysis of the Informal Hawala System' (World Bank and the IMF 2003) 3.

The term 'hawala' stems from the Arabic for 'change' or 'transform'. Defined as a bill of exchange or promissory note, this process facilitates the movement of funds across international boundaries without recourse to the formal banking system, neither does cash change hands.¹⁴⁵ There is usually no written record of the transaction and no legal form of redress if the debt remains unpaid by the original *hawaladar*. Only a bond of trust therefore secures the debt.¹⁴⁶ The element of trust obviates the need to rely on written documentation and articulate in detail the responsibilities of the parties to the transaction.¹⁴⁷ The IVTS has been described as the poor man's private banking vehicle in as much as they provide a personalised service, informality, security and confidentiality.¹⁴⁸ The system for many people in remote areas of the world has been described as 'faster, cheaper and more reliable than Citibank'.¹⁴⁹

Many observers note the failure of the financial infrastructure in the "formal" economy, both in developed and developing countries, to offer efficient services to migrant workers. It is considered a religious duty for Muslims to provide for their families as part of a broader Islamic ideal, as discussed above, and such support has been traditionally provided by means of IVTS such as Hawala. Hawaladars are usually highly visible within the community, often operating out of shops or running other businesses such as currency exchanges.¹⁵⁰ IVTS have also experienced strong growth in areas of instability and political unrest and have proved a useful conduit for transferring funds for humanitarian relief and in some cases offer the only option.¹⁵¹

¹⁴⁵ Millard Burr and Robert Collins, *Alms for Jihad: Charity and Terrorism in the Islamic World* (CUP 2006) 71-72.

¹⁴⁶ Leonides Buencampo and Sergei Gorbunov, 'Informal Money Transfer Systems: Opportunities and Challenges for Development Finance' (DESA Discussion Paper No.26, UN Department of Economics and Social Affairs 2002) 2.

¹⁴⁷ *ibid* 6.

¹⁴⁸ *ibid*.

¹⁴⁹ William Wechster, Director for Transnational Threats at National Security Council, quoted in 'Bin Laden's Money Takes Hidden Paths to Agents of Terror' *The Washington Post* (Washington DC, 21 September 2001).

¹⁵⁰ FATF, 'The Role of Hawala and Other Similar Service Providers in Money Laundering and Terrorist Financing' (FATF/OECD October 2013) 9.

¹⁵¹ Mohammed El Qorchi, Samuel Munzele Maimbo and John F Wilson, 'Informal Money Transfer Systems: An Analysis of the Informal Hawala System' (International Monetary Fund/World Bank 24 March 2003 21).

Traditional legitimate hawala transfer services provide an essential service for many, however, they may also offer a useful financial conduit for terrorists. The FATF has evidence that hawalas have been taken over by criminals once an established network has attracted their attention or been established and operated by criminals to launder proceeds of drug trafficking, evade currency controls, tax obligations and sanctions.¹⁵²

There are no reliable measures of the volume of money flowing through IVTS, however, estimates range from \$100 billion to \$300 billion.¹⁵³ The FATF concluded that most countries were unable to provide estimates on the scale of unregulated hawalas and similar providers, or the scale of the relative threat of misuse by terrorists.¹⁵⁴ Although the total is undoubtedly significant, the amounts involved per transaction and per person are generally small. An exceptional case however came to light in 2006 when a hawaladar, known as 'Patel', operating in Italy was estimated to have handled payments amounting to \$4million per day.¹⁵⁵

Having carried out extensive interviews with NPO representatives, Shanahan reported that several international organisations used the Hawala system to transfer funds to where they were needed when there was no alternative available.¹⁵⁶ In Somalia, for example, aid agencies transferred cash via hawalas as a means of reaching large numbers of people in stricken areas of the country.¹⁵⁷ This highlights the difficult choice that many NPOs have to make between the risk attached to the transfer of funds, the cost involved and the risk to potential recipients if they are not able to deliver humanitarian aid.

¹⁵² FATF (n 150) 13-14.

¹⁵³ Buencampo and Gorbunov (n 167) 2

¹⁵⁴ FATF (n 146) 8.

¹⁵⁵ Rhys Jones, 'The Money Changers' (2007) 374 *The Middle East* 38-40.

¹⁵⁶ Rodger Shanahan, 'Charities and Terrorism: Lessons from the Syrian Crisis' (Lowy Institute 14 March 2018).

¹⁵⁷ Overseas Development Institute, 'Doing Cash Differently: How Cash Transfers can Transform Humanitarian Aid' (September 2015) 16.

Passas argues that, although some funding of terrorism through IVTS undoubtedly takes place, there is scant evidence to suggest that this would be the preferred method of choice, and concludes that such methods are no more vulnerable to abuse than the formal financial services sector.¹⁵⁸ In any event for some analysts Hawala should be considered an 'end-user' tool for terrorists operating in remote areas rather than a primary tool for operational purposes.¹⁵⁹

5.4 The utility of cash-and of cash smuggling

For some economies cash is the dominant means of transacting. In Syria, for example, according to the US State Department, 60% of all business transactions are carried out in cash and nearly 80% of Syrians do not use the formal banking system.¹⁶⁰ Thus either cash or informal unregulated systems could be used as an alternative, both open to abuse by terrorists.

Aside from exploitation of charities and the misdirection of zakat in Saudi Arabia, the prevalence of cash transactions within the kingdom gave cause for concern; particularly in the post 9/11 when more emphasis began to be placed on transparency in financial transactions. The US ambassador to Saudi Arabia Robert Jordan, who took up post shortly after the terrorist attack in 2001 noted 'This was a cash-based economy, money was raised, stored and transferred in cash; the country was awash with cash...In matters of transparency and accountability in charities the bar was set very low, the formulation of counter-terrorist finance policy was not considered a priority at the time'. However, with the spotlight focusing on financial practices, and heightened awareness of terrorist financing within charities, 'the Saudi government was willing, in my opinion, to clamp down on questionable practice'.¹⁶¹

¹⁵⁸ Passas (n 143) 17.

¹⁵⁹ Brisard (n 39) 10.

¹⁶⁰ US State Department, 'Country Reports on Terrorism 2012' (May 2013) ch 3.

¹⁶¹ Personal discussion with Robert Jordon US Ambassador to Saudi Arabia 2001-2003 on 26 June 2017.

Terrorist groups have used both bulk cash smuggling and cash couriers as a means of moving funds. The former involves large volumes of cash, being moved across borders, often concealed in vehicles or cargo containers and sometimes even via the postal service. The benefits of retaining monies in cash being; to keep the monies outside the financial system with its consequent danger of detection, and to distance the monies from criminal origins. Money moved in this way reaches its destination relatively quickly with the added advantage of requiring minimal advance planning.¹⁶²

Cash couriers are typically used to move smaller amounts, although sometimes several will be used for one consignment in order to mitigate the risk of a courier being apprehended. The preferred mode of transport appears to be by commercial airlines, although there have been cases where private planes have been used. Larger denomination notes are typically transported, as the courier needs to comply with weight and luggage size restrictions.¹⁶³

The FATF found that large amounts of cash were a feature of most of the cases of terrorist financing studied in the West Africa region, which may have been converted from other means of stored value, having the advantage of being less detectable. Boko Haram also reportedly used women as cash couriers as they would not be searched by male border security guards.¹⁶⁴

5.5 Commodities as stored value

Not only have certain commodities proved useful in raising and storing funds, but they have also been exploited as an opaque vehicle to move funds. An example of the second type of informal value transfer 'stored value' is the use of gold and diamonds.

¹⁶² FATF, 'Global Money Laundering and Terrorist Financing Threat Assessment' (FATF/OECD July 2010) 16.

¹⁶³ *ibid* 17.

¹⁶⁴ FATF, 'Terrorist Financing in West Africa' (FATF/OECD 2013) 22-24.

Donations in the form of gold were often made to Al-Qaeda, which could then be moved around undetected.¹⁶⁵ Certain characteristics of gold as a commodity make it attractive to criminals, aside from its stable value as an investment vehicle. 'Information bottlenecks' have been identified in that gold is often accepted and processed where the source is either ambiguous or unknown. Recycled gold is frequently traded on a cash basis, which affords the anonymity associated with operating outside formal banking channels. In addition, the commodity can be easily smuggled and is accepted and exchangeable worldwide, both physically and virtually.¹⁶⁶

The business practices of the transnational diamond trade have certain unique characteristics; often agreements are made orally, transactions undocumented, there is a degree of anonymity in the process and deals can often take place in exchanges situated in Free Trade Zones (FTZ). Diamonds have the advantage of retaining their value, having a high value-to-mass ratio, being easy to transport and difficult to trace. They may be useful to terrorists as a form of currency, or to generate profit.¹⁶⁷

Bitcoin, the de-centralised electronic currency, and other crypto currencies represent an emerging new generation of finance. Skinner outlines the concern of various governments worldwide that Bitcoin can facilitate the movement of money anonymously and without government control. As such it has been labelled as an economy fuelling both criminal activity and terrorism.¹⁶⁸

Where terrorist logistical networks involve a chain of personnel to carry out acts of terrorism from recruits to suppliers and couriers, the human chain can be detected and intercepted. For example, US intelligence on Bin Laden's trusted

¹⁶⁵ 'Al-Qaeda and the Gold Trail that leads through Dubai to September 11' *The Guardian* (London, 19 February 2002).

¹⁶⁶ British Jewellers Association and National Association of Goldsmiths, 'The Gold Paper' (2013).

¹⁶⁷ FATF, 'Money Laundering and Terrorist Financing Through Trade in Diamonds' (FATF/OECD October 2013) 5-10.

¹⁶⁸ Chris Skinner, 'Bitcoin: All Hype or a Brave New World?' (2014) 163 *The Banker* 70.

courier finally led them to the compound in Abbottabad.¹⁶⁹ Crypto currencies however have the potential to by-pass systems of detection making them an attractive means of moving money. Software is available which allows peer-to-peer Bitcoin transactions to take place whereby the transaction merges with other transactions, thus providing anonymity.¹⁷⁰

In a disturbing report for the Henry Jackson society, Malik details cases where bitcoin was used to facilitate terror attacks; by an IS-affiliated donor who was instrumental in organising terror attacks in Indonesia, and an Al-Qaeda-linked organisation running a social media campaign to secure bitcoin donations via Facebook and Twitter stating ‘...you can send money to the Mujhideen 100% anonymously with cash. It really is that simple’.¹⁷¹

Bitcoin however does not provide complete anonymity, as blockchain transactions provide a virtual record of transactions which may dissuade terrorists from its use. Anecdotal evidence though suggests that terrorist supporters have been urged to use the ‘dark wallet’ as a less traceable alternative and moving towards newer cryptocurrencies such as Monero which affords enhanced privacy and less transparency.¹⁷² Again it is impossible to gauge the extent of use of these new technologies by criminals and terrorists but such developments may become major challenges in the future and require close monitoring and regulatory oversight.

6. CONCLUSION

This chapter has highlighted some of the characteristics associated with terrorist financing and the environment in which terrorists operate; the

¹⁶⁹ M Ilyas Khan, ‘Who was the courier who led US to Bin Laden?’ (*BBC News*, 5 May 2011) <http://www.bbc.co.uk/news/world-south-asia-13300680> accessed 1 march 2020.

¹⁷⁰ Jen Copestake, ‘Hiding Currency in the Dark Wallet’ (*BBC News*, 19 September 2014) <http://www.bbc.co.uk/news/technology-29283124> accessed 1 March 2020.

¹⁷¹ Nikita Malik, ‘Terror in the Dark. How Terrorists Use Encryption, the Darknet and Cryptocurrencies’ (The Henry Jackson Society 2018) 41-42

¹⁷² *ibid* 43-44.

multiple sources of financing available, from state sponsorship to the myriad of acquisitive crimes as well as opportunities to use legitimate businesses as a front. The constantly evolving nature of terrorism itself and the means by which it is financed often adapts to accommodate a constantly shifting risk landscape. The relationship between the criminal world and that in which terrorists operate is often in synergy and may also converge within the operating environment of NPOs, especially in geographical areas of political instability where possibly the humanitarian need is greatest. Ease of access to financial services through formal banking structures and IVTS have provided opportunities for NPOs both to store funds and to transfer funds to where they are needed. The same structures are also available to terrorists to move funds for both their organisational requirements, and for operational purposes.

The unique position of NPOs, the vulnerabilities they present, and the opportunities afforded to terrorists for abuse of the sector, as one of many, have been discussed in this chapter.¹⁷³ There is, however, a lack of convincing empirical evidence to substantiate claims that the charity sector as a whole is particularly vulnerable.¹⁷⁴

Muslim charities may have specific vulnerabilities though due to the zakat system of charitable giving which underpins Muslim civic society, with issues of anonymity of donors and in some areas less regulatory oversight. Potential issues relating to perceptions of the vulnerability to abuse of Islamic banking and its use by charities have also been highlighted. This leads to the questions addressed in the following chapters, and more specifically in the empirical chapters, as to whether there are unintended consequences flowing from the

¹⁷³ Focusing more directly on illegitimate NPOs, for example sham or 'front' organisations, whereas the cohort of interviewees were involved in legitimate organisations, which may nevertheless display vulnerabilities leaving them open to exploitation.

¹⁷⁴ See for example; Stuart Gordon, 'The Risk of De-risking: The Impact of Counterproductive Financial Measures on the Humanitarian Response to the Syrian Crisis' (20 March 2019) <https://blogs.lse.ac.uk/crp/2019/03/20/the-risk-of-de-risking-the-syrian-crisis/> accessed 1 March 2020; Peter Romaniuk and Tom Keatinge, 'Protecting charities from terrorists...and Counter-terrorists: FATF and the Global Effort to Prevent Terrorist Financing Through the Non-profit Sector' (2018) 69 *Crime Law and Social Change* 265, 268.

implementation of the regulation designed to address the problem of terrorist financing, and whether Muslim charities may be particularly prejudiced in this regard.

The characteristics of terrorist financing, and the wider environment in which terrorists operate is dynamic, uncertain and complex, as demonstrated in this discussion, presenting particular challenges to the international community of policy makers and law enforcement agencies. Understanding this and having the capability to monitor financial activities of both terrorist groups and lone actors is essential in the provision of intelligence with which to direct future counter-terrorist finance policy. Decisions which effect NPOs are thus influenced by the constantly changing behaviours of terrorists. The developing legal framework in response to this evolving threat will be discussed in the next chapter, with particular reference to the global non-profit sector.

CHAPTER 4: THE DEVELOPING INTERNATIONAL COUNTER-TERRORIST FINANCE LEGAL FRAMEWORK AND IMPLICATIONS FOR THE NON-PROFIT SECTOR

1. INTRODUCTION

This chapter considers the evolving legal framework and the focus by the international community, particularly in the aftermath of 9/11, more directly on terrorist financing as a distinct financial crime. The role of the pivotal structures in the regulatory framework and the position of the non-profit sector against this legal backdrop is particularly relevant.

In this burgeoning area of regulation, which had received scant attention prior to 9/11, the non-profit sector was recognised as an area of concern by international bodies such as the Financial Action Task Force (FATF) and the UN, and as such specific recommendations were made by the FATF for countries to take appropriate measures to safeguard the sector from abuse.¹ The requirement for collaboration, cooperation and mutual evaluation of countries adherence to international standards set by the FATF, became central themes in the evolving counter-terrorist finance (CTF) framework. The FATF Recommendations and consequences for non-cooperation, as well as wider questions of the legitimacy of this powerful, influential organisation will be considered, before focusing specifically on the NPO sector. Matters of compliance as well as unintended consequences of policy could affect the business of NPOs, and their position within this new and evolving framework will form the basis for further discussion in this chapter.

Wider issues having an impact on NPOs will be discussed in the final section of this chapter. The lack of a universally accepted definition of terrorism and the asset freeze regimes which have become an integral part of the regulatory framework, have influenced where NPOs may operate and with whom they may

¹ FATF, 'FATF IX Special Recommendations on Terrorist Financing' (FATF/OECD 2001).

legally have dealings. The idea of what constitutes terrorism differs widely between governments, societies and academics, with some offering a broad definition whilst others are more narrowly framed.² The lack of a universally accepted definition of terrorism has presented difficulties in defining terrorist finance as a distinctive form of criminal activity and may have practical implications for the due diligence requirements of organisations, therefore relevant to this discussion.

It was evident that monies used for terrorist purposes were passing through informal financial systems as well as the formal banking system, as outlined in Chapter Three; the response was aimed at both, and transactions and transaction patterns became central to security practice. The role of the banking sector will be considered and the perception of risk, which may affect their relationship with stakeholders, including those from the NPO sector. This interoperability between parties which are subject to counter-terrorist financing requirements will be discussed against this regulatory backdrop.

2. PIVOTAL STRUCTURES OF THE REGULATORY FRAMEWORK

2.1 The role of the United Nations

A principal purpose of the United Nations (UN), set out in its Charter, is to 'maintain international peace and security, and to that end: to take effective measures for the prevention and removal of threats to the peace...'³ The original membership of 51 countries subscribing to the Charter in 1945 has now increased to 193 sovereign states, the latest to join being South Sudan in 2011.⁴ The United Nations Security Council (UNSC) is empowered to make Resolutions, which carry an obligation for all member states to act, should a threat to international peace and security arise.⁵

² Alex Schmid, 'The Response Problem as a Definition Problem' in John Horgan and Kurt Braddock (eds), *Terrorism Studies* (Routledge 2012) 92.

³ United Nations, 'Charter of the United Nations' (I UNTS XVI, 24 October 1945) Ch I Article 1.

⁴ United Nations, 'United Nations: Overview' <http://www.un.org/en/sections/about-un/overview/index.html> accessed 1 March 2020.

⁵ UN, 'Charter of the United Nations' (n 3) ch VII.

The question of terrorist financing prior to the 1998 bombings of the US embassies in Kenya and Tanzania had traditionally been viewed as one of state sponsorship, money laundering, and of financing through criminal activity. Counter terrorist finance initiatives were therefore directed and targeted accordingly.⁶ The UN through various treaties and resolutions, for example, sought to put pressure on states to desist from sponsoring terrorism.⁷

2.2 The role of the Financial Action Task Force

The rising concern over the threat posed by money laundering in the international banking sector prompted the Group of Seven (G-7) to establish the Financial Action Task Force on Money Laundering (FATF) in 1989, at their Paris Summit. Convened from member states of the G-7 as well as eight other countries and the European Commission, this policy-making body was tasked with examining existing money laundering trends and techniques, reviewing action taken both at national and international levels, and determining additional measures required to address the problem.⁸ It was recognised that money laundering had become an international phenomenon, and international cooperation was required to enforce anti-money laundering legislation.⁹

The FATF thus set forth to institute monitoring mechanisms and to co-ordinate international anti-money laundering laws. At its first meeting, less than a year later, the FATF published its action plan in the form of a report containing 40 Recommendations to combat money laundering. The aim of this guidance material was to transcend differences between judicial systems.¹⁰

Member countries were required to; provide mutual assistance and cooperation

⁶ Anne Clunan, 'The Fight Against Terrorist Financing' (2006) 121 (2) Political Science Quarterly 569, 574.

⁷ *ibid.*

⁸ FATF, 'Financial Action Task Force-30 Years' (FATF/OECD 2019).

⁹ Lisa Barbot, 'Money Laundering: An International Challenge' (1995) 3 Tulane Journal of International and Comparative Law 161, 171.

¹⁰ Jean-Marc Sorel, 'Some Questions About the Definition of Terrorism and the Fight Against its Financing' (2003) 14 (2) European Journal of International Law 365, 373.

in ML investigations, including extradition; refrain from enacting secrecy laws which could jeopardise investigations; criminalise money laundering (not just drug-related laundering but other activities generating significant criminal proceeds); to hold corporations as well as employees criminally liable; and to encourage enhanced due diligence measures.¹¹

FATF direct membership is drawn from countries considered to be 'strategically important' in terms of GNP, population size and the importance of its financial sector.¹² They are also required to demonstrate commitment to the FATF standards and to be members of international organisations such as the IMF. For non-members, adopting anti-money laundering (AML)/CTF policies can demonstrate the adoption of shared values in line with the body of favoured members. An exercise with symbolic value may provide developing states with a semblance of international respectability.¹³

Romaniuk and Keatinge note that, although terrorist financing through charities was not unknown in this pre-9/11 time period, it had been accorded scant attention. Accordingly, there were few countermeasures in place against NPOs by individual states. At this stage the FATF 40 Recommendations neither included terrorist financing nor was any mention of NPOs made.¹⁴

2.3 Other supporting structures

Various working groups were established to assist in the implementation of the UN Global Counter-Terrorism Strategy (the Strategy) in 2006.¹⁵ The Working Group on Tackling Financing of Terrorism, led by the IMF, World Bank and

¹¹ FATF, 'The Forty Recommendations of the Financial Action Task Force on Money Laundering 1990' (FATF OECD 1990).

¹² Nicholas Turner, 'The FATF: International Regulatory Convergence Through Soft Law' (2014-2015) 59 *New York Law School Review* 547, 553.

¹³ Jason Sharman, 'Power and Discourse in Policy Diffusion: Anti-money Laundering in Developing States' (2008) 52 *International Studies Quarterly* 635, 649.

¹⁴ Peter Romaniuk and Tom Keatinge, 'Protecting Charities from Terrorists and Counter-terrorists: FATF and the Global Effort to Prevent Terrorist Financing through the Non-profit sector' (2017) 69 *Crime Law Soc Change* 265, 267.

¹⁵ 'UN Global Counter-Terrorism Strategy' (UN Doc. A/RES/60/288 adopted 8/9/2006) The aims of the strategy will be discussed later in this chapter.

United Nations Office on Drugs and Crime (UNODC) considered CTF strategies, making proposals on their findings to enhance compliance with international standards. Particular vulnerabilities were reported in relation to cash couriers and the role of charitable organisations in relation to terrorist financing.¹⁶

Another influential structure is the Wolfsberg Group, an association of 11 banks, previously concerned with reviewing AML standards within the private banking sector.¹⁷ The Wolfsberg Principles, although a voluntary code lacking enforcement mechanisms, came to underpin regulatory guidance and, due to its extensive membership had the potential to become the leading standards throughout the industry, and to impact national legislation.¹⁸

The primary purpose of the IMF, with nearly universal membership of 189 countries, is to safeguard the stability of the international monetary system.¹⁹ Originally focusing on AML, the IMF also broadened its remit to include CTF activity post 9/11. As well as the moral imperative to tackle terrorist financing, the IMF recognised the negative impact that terrorist financing has on the global financial system, which has wider implications for national and international macroeconomic stability.²⁰ The IMF helped formulate CTF policies, working closely with the FATF, the World Bank and other international bodies. It also reviews countries AML/CTF policies and compliance with international standards, as well as monitoring financial and economic developments through its 'Surveillance' programme.²¹

The Egmont Group also supports the work of international bodies such as the FATF. Established in 1995 as an informal network of Financial Intelligence Units

¹⁶ UN Counter-terrorism Implementation Task Force (CTITF) Working Group, 'Tackling the Financing of Terrorism' (CTITF October 2009)12-16.

¹⁷ Gemma Aiolfi and Hans-Peter Bauer, 'The Wolfsberg Group' in Mark Pieth (ed) *Collective Action: Innovative Strategies to Prevent Corruption* (Dike 2012).

¹⁸ Mark Pieth and Gemma Aiolfi, 'The Private Sector Becomes Active: The Wolfsberg Process' (2003) 10 (4) *Journal of Financial Crime* 359, 362.

¹⁹ IMF, 'The IMF at a Glance' (Fact Sheet, March 2019).

²⁰ IMF, 'The IMF and the Fight Against Money-laundering and the Financing of Terrorism' (Factsheet, March 2019)

²¹ *ibid.*

(FIUs) seeking to explore means to foster international co-operation to combat terrorist financing and money laundering.²² Global membership has grown rapidly, and now includes 164 FIUs.²³ Due to the expectation of the FATF in its 2012 recommendations that FIUs apply for membership of the Group,²⁴ this total is set to rise.²⁵ The institution is now formalised, and its sphere of influence increased, for example, in hosting an electronic communication system for sharing information with members regarding financial transactions, and other sensitive information.²⁶

3. THE DEVELOPING FRAMEWORK-LEGAL INTERVENTIONS PRE-9/11

An important early initiative by the UN with respect to terrorist financing was the adoption of UNSCR 1267 in October 1999.²⁷ Margulies notes the significance of this resolution in addressing the dilemma of lack of collective action by states, which had hitherto impeded meaningful progress in tackling the financing of terrorism. The resolution required collaboration in identifying, taking action against and deterring terrorist financing.²⁸ There was mounting concern in the international community of the growing threat posed by Al-Qaeda, and the UNSC considered that the threat to international peace and security warranted an international response. The Taliban, representing the de facto government in Afghanistan, were accused of providing a safe haven for Al-Qaeda operatives, allowing the sheltering and training of terrorists, who were able to plan and execute terrorist attacks.²⁹ A sanction regime and committee was established pursuant to this resolution, charged with monitoring the implementation of

²² David Bulloch, 'Tracking Terrorist Finance: The SWIFT Program and the American Anti-terrorist Finance Regime' (2011) 3 *Amsterdam Law Forum* 74, 97.

²³ 'The Egmont Group of Financial Intelligence Units'

<https://www.egmontgroup.org/en/content/about> accessed 24 September 2019.

²⁴ FATF, 'International Standards on combating Money Laundering and the Financing of terrorism and proliferation (The FATF Recommendations)' (FATF/OECD 2012) 96.

²⁵ Six new FIUs have joined in the three months to 24 September 2019.

²⁶ Vijayah Ramachandran, Mathew Collin and Matt Juden, 'De-risking: An unintended Negative Consequence of AML/CFT Regulation' in Colin King, Clive Walker and Jimmy Gurulé (eds), *The Palgrave Handbook of Criminal and Terrorist Financing Law* (Palgrave 2018) 260.

²⁷ UN Doc. S/RES/1267/1999.

²⁸ Peter Margulies, 'Aftermath of an Unwise Decision: The U.N Terrorist Sanctions Regime After Kadi II,' (2014) 6:2 *Amsterdam Law Forum* 51, 52.

²⁹ UN Doc. S/RES/1267/1999.

sanctions (initially limited to a flight ban and asset freeze) imposed on the Taliban and associated individuals, and responsible for the Al-Qaeda sanctions list and its continued maintenance.³⁰ Although sanctions had been employed by the UNSC previously, this regime was directed, for the first time, towards a non-state actor. The sanction regime within Taliban-controlled Afghanistan was broadened to an arms embargo and the scope of the asset freeze extended to non-state entities including Al-Qaeda, Osama Bin Laden and individuals and entities associated with them.³¹

The Security Council has modified, refined and strengthened the sanction regime on numerous occasions since its inception, according to the changing nature of the threat. Following on from UNSCR 1267, the UNSC continued its involvement in the international struggle against Al-Qaeda with the adoption of the International Convention for the Suppression of Financing of Terrorism (1999), (Terrorist Financing Convention).³²

The 1999 Convention, taking a different approach to its predecessors, sought to address the phenomenon of terrorist financing as a whole, rather than focusing on individual acts of terrorism. States parties to this Convention are under an obligation to “take appropriate measures, in accordance with its domestic legal principles, for the identification, detection and freezing or seizure of any funds...” used or assigned for the purpose of committing terrorist activities.³³

States parties are furthermore required to regulate financial institutions within their jurisdiction, in recognition of their position in the first line of defence against terrorist financing.³⁴ They are required to ‘report all complex, unusual large transactions and unusual patterns of transactions, which have no apparent economic or obviously lawful purpose.’³⁵ Further actions states are urged to

³⁰ *ibid.*

³¹ UN Doc. S/Res/1333/2000.

³² Terrorist Financing Convention adopted by the UN General Assembly in Resolution 54/109 of 9/12/1999 entered into force April 2002.

³³ Article 8 Terrorist Financing Convention.

³⁴ Jimmy Gurulé, *Unfunding Terror: The Legal Response to the Financing of Global Terrorism* (Edward Elgar 2008) 155.

³⁵ Terrorist Financing Convention (n 32) Article 18 para 1(b)(iii).

consider is licensing money-transmission agencies and take appropriate steps to 'detect and monitor the physical cross-border transportation of cash and bearer negotiable instruments...'³⁶

Although the Convention specifically addressed the question of terrorist financing, Sorel maintains that it added few new measures to the armoury of CTF, whilst restating standardised clauses found in previous conventions.³⁷ Furthermore, reference to NPOs as a potential source of terrorist financing was only made in one of the non-operative paragraphs in the preamble.³⁸ Ryder however accords it greater importance; observing that the criminalisation of terrorist financing, and financial intelligence gathering is given prominence in this Convention, and clearly represents a founding instrument for what became known as the 'Financial War on Terrorism.'³⁹

One of the weaknesses identified at the time, however, lies in the absence of an international monitoring body and enforcement mechanisms attached. Applying only to signatory countries to the Convention, any enforcement of its provisions necessarily had to come through the member states.⁴⁰ The Terrorist Financing Convention also allows for individual interpretation. For example, states have the option not to comply with requests for legal assistance or extradition if the purpose is, in their considered opinion, to prosecute or punish on account of a person's 'race, religion, nationality, ethnic origin or political opinion,' which would prejudice that person's position.⁴¹ Thus affording the state the opportunity to interpret terrorism according to its own political motivation.⁴²

³⁶ Terrorist Financing Convention (n 32) Article 18 para 2(a) and (b).

³⁷ Sorel (n 10) 373.

³⁸ Preamble to the Terrorist Financing Convention para 6.

³⁹ Nicholas Ryder, *The Financial War on Terror: Review of Counter-terrorist Finance Strategies Since 2001* (Routledge 2015) 35.

⁴⁰ Angela Hardister, 'Can we buy Peace on Earth? The Price of Freezing Terrorist Assets in a post-September 11 World' (2003) 28 *North Carolina Journal of International Law and Commercial Regulation* 605, 625.

⁴¹ The Terrorist Financing Convention Article 5.

⁴² Sorel (n 10) 372.

Article 12(2) was a particular barrier to acceptance for many states for whom the notion of bank secrecy was considered the foundation of commercial success. This Article requires mutual cooperation, and the doctrine of bank secrecy could not be cited as justification for refusal to cooperate in criminal investigations, or extradition proceedings between states.⁴³

Open for signature in January 2001 the Convention was largely ignored at the time, with only 41 signatory countries prior to the terrorist events of 9/11.⁴⁴ Immediately post 9/11, the number of ratifications increased significantly to 154, demonstrating that states have taken action that they would not have otherwise done.⁴⁵

4. THE CURRENT LEGAL LANDSCAPE

In the immediate aftermath of 9/11 there was a growing recognition that the problem of generation and distribution of funds for terrorism required 'a level of international cooperation far greater than required at military and diplomatic levels.'⁴⁶ The 'financial war on terror', which had begun with President Clinton in his recognition of al Qaeda's role in the US embassy bombings, thus gathered momentum.⁴⁷

The swift response to the terrorist attacks from the US came in the form of a Presidential Executive Order (Executive Order 13224),⁴⁸ allowing the freezing of assets of those identified as having links to terrorists, or potentially having provided funds to Al-Qaeda: this list was substantially extended thereafter. By December of the same year the US Treasury reported 'aggressive action

⁴³ Ilias Bantekas, 'The International Law on Terrorist Financing' in Ben Saul (ed) *Research Handbook on International Law and Terrorism* (Edward Elgar 2014) 122.

⁴⁴ Hardister (n 40) 624.

⁴⁵ Clunan (n 6) 578.

⁴⁶ Martin Navias, 'Finance Warfare as a Response to International Terrorism' (2002) 73 *The Political Quarterly* 57, 76.

⁴⁷ Nicholas Ryder and Umut Turksen, 'Banks in Defence of the Homeland: Nexus of Ethics, Legality and Suspicious Activity Reporting in the United States of America' (2013) 12(4) *Contemporary Issues in Law* 311, 312.

⁴⁸ Executive Order No. 13224 of September 23, 2001 Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten to Commit, or Support Terrorism.

against the bankers of terrorism,' and the designations of 158 individuals and organisations pursuant to this executive order.⁴⁹ The ability to freeze assets was not unprecedented, having been used against Al-Qaeda prior to 9/11, however, this weapon became central to the battle against the financing of terrorism, and the US led the world in this component of CTF policy.⁵⁰ The Executive Order received legislative backing in the passing of the USA Patriot Act.⁵¹ Thus, a two-pronged attack was launched which aimed to freeze terrorist assets and to dislocate the financial infrastructures that supported them.⁵²

The US has taken the lead in the global fight against terrorist finance, instigating unprecedented law enforcement and intelligence initiatives which aim to inhibit the capability of terrorists to travel, to deny them access to the international financial system and the ability to raise, move and store the funds necessary to carry out attacks.⁵³ Seen by many as an immediate but short-term response to the terrorist attacks, the provisions of the USA Patriot Act has had long term consequences for the US domestic non-profit sector, which will be discussed later in the chapter.⁵⁴

Other regional organisations also took decisive action. The European Council, for example, called for a united European front against terrorism, approving a comprehensive 'Plan of Action'.⁵⁵ Some of the agreed measures included; the creation of a 'suspected' and 'known' terrorist register; the introduction of a European arrest warrant, attempting a definition of terrorism, and establishing

⁴⁹ US Department of the Treasury, 'Terrorist Financing Fact Sheet' 20 December 2001 <https://www.treasury.gov/press-center/press-releases/Pages/po886.aspx> accessed 1 March 2020.

⁵⁰ Ryder (n 39) 89.

⁵¹ USA: Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act 2001 (USA Patriot Act)

⁵² Hardister (n 40) 606.

⁵³ Matthew Levitt, 'Stemming the Flow of Terrorist Financing: Practical and Conceptual Challenges' (2003) 27 Fletcher Forum of World Affairs (Spring/Winter) 59, 61.

⁵⁴ Charity and Security Network (CSN) 'How the Work of Charities Can Counter Terrorism: And How US Laws get in the Way' (CSN/CORDAID 2009)

⁵⁵ Council of the European Union, 'Conclusions and Plan of Action of the Extraordinary European Council meeting on 21 September 2001' [2001] OJ (SN 140/01).

a Financial Intelligence Unit in each member state.⁵⁶ The plan effectively bound member states to a long-term strategy that would transcend the national priorities of rotating presidents.⁵⁷ Zagaris emphasises the importance and potential influence of policies emanating from the EU, due to the pre-eminence of EU nations in the FATF as well as other influential international organisations.⁵⁸

4.1 The influence of the UN post 9/11 and the asset freeze regime

The UNSC Resolution 1373, adopted shortly after 9/11, reaffirmed the principle established by both General Assembly and Security Council that every state should refrain from 'organising, instigating, assisting or participating in terrorist acts in another State.'⁵⁹ It was recognised, however, that compliance at state level would present numerous legal and technical challenges. The newly-established Counter-terrorism Committee (CTC) was charged with facilitating domestic legislation in all areas of activity proscribed by this resolution, and to provide technical assistance and training.⁶⁰ It was also responsible for both monitoring state compliance and the enforcement of the obligations.⁶¹ The establishment and maintenance of an effective police and intelligence framework was also deemed necessary in order to detect and monitor terrorist activity.⁶²

The freezing of financial assets is one of the measures known as smart sanctions or targeted sanctions, denying those who are listed the means to support terrorism by ensuring economic resources are unavailable to them.⁶³ They effectively apply external pressure on individuals with the objective of affecting

⁵⁶ Bruce Zagaris, 'The Merging of the Anti-money Laundering and Counter-terrorism Financial Enforcement Regimes After September 11, 2001' (2004) 22 *Berkeley Journal of International Law* 142-143.

⁵⁷ Oldrich Bures, *EU Counterterrorism Policy: A Paper Tiger?* (Ashgate 2011) 64.

⁵⁸ Zagaris (n 56).

⁵⁹ UNSC Resolution 1373, UN Doc. S/RES/1373 (2001).

⁶⁰ Gurulé (n 34) 241.

⁶¹ Paul Norman, 'From Enforcement to Strategic Partnership: The Contemporary Challenge of the United Nations in Countering Terrorism' (2007) 20(3) *Security Journal* 197, 201-202.

⁶² *ibid* 202-203.

⁶³ Al-Qaeda Sanctions Committee, 'Asset Freeze Explanation of Terms' (24 May 2015).

a change in their behaviour, as opposed to targeting a nation state.⁶⁴ UNSCR 1373 builds on UNSCR 1267, authorising states to freeze assets of any person or entity involved in terrorism. Such action has been taken against groups including HAMAS, Hezbollah and FARC,⁶⁵ and could clearly affect the way bodies such as NPOs can legally operate.

The UN General Assembly, responding to concerns that the UNSC-led counter terrorism framework was focusing primarily on security measures, adopted the 2006 Strategy, mentioned earlier, offering a more holistic approach.⁶⁶ The aim was to provide a practical action plan to encompass issues such as human rights, the rule of law, the prevention and resolution of conflicts as well as development and educational programmes.⁶⁷ This move to increase their sphere of influence beyond legal and law enforcement mechanisms was required as a response to the abrogation of human rights concerns by some states in their application of CTF measures. As a result, according to Norman, the long-term legitimacy and relevance of the Strategy is assured.⁶⁸

The UN recognised that the non-profit sector plays a key role in fighting conditions conducive to terrorism.⁶⁹ Furthermore the volume of any terrorist-related funds passing through the sector would be minimal in comparison to the total, and as such the CTITF cautioned that broad rhetoric associating NPOs with terrorist financing should be avoided, and any action that needs to be taken should be proportionate to the risk posed. The removal of a suspect individual within an organisation may be sufficient rather than taking steps to immediately close the whole organisation,⁷⁰ which had been the US government response to the threat.⁷¹

⁶⁴ Iain Cameron, 'European Union Anti-terrorist Blacklisting' (2003) 3 (2) Human Rights Law Review 225, 226.

⁶⁵ Gurulé (n 34) 239.

⁶⁶ Charity and Security Network, 'UN Counterterrorism Framework: Key Programs and Tools' http://www.charityandsecurity.org/analysis/UN_Counterterrorism_Framework_Key_Programs_and_Tools accessed 1 March 2020.

⁶⁷ *ibid.*

⁶⁸ Norman (n 61) 207.

⁶⁹ CTITF (n 16) para 64.

⁷⁰ *ibid* para 62-72.

⁷¹ See s 5.1.4.

4.2 9/11 and the FATF

In parallel with the developments from the UN, the FATF took decisive action post 9/11, extending its mission and directing its expertise to develop CTF standards, as the money trail, discovered in the aftermath, clearly underlined vulnerabilities in the international financial system.⁷² The FATF acquired greater authority and influence in its affiliation to US national security strategies in this period.⁷³ The combination of Executive Order 13224 and the USA Patriot Act had far-reaching implications enabling the substance to be effectively imposed on all UN states through the vehicle of UNSCR 1373.⁷⁴

4.2.1 The development of the Recommendations

This resulted in the publication of eight ‘Special Recommendations’(SRs) on terrorist finance (a ninth being added in 2004), in addition to the above-mentioned 40 concerning AML,⁷⁵ the first of which (SR I) required member countries to ratify and implement the Terrorist Financing Convention (1999) and relevant UN resolutions (e.g. UNSCR 1373). The FATF Special Recommendations also required states to criminalise financing of terrorism, terrorist organisations and terrorist acts (SR II); freeze, seize and confiscate terrorist assets (SR III); ensure financial institutions (and others) report suspicious transactions relating to terrorism (SR IV); cooperate with other countries’ law enforcement and regulatory authorities in detecting and punishing terrorist financing (SR V); regulate alternative remittance systems (SR VI); strengthen identification measures for those using both domestic and international inter-bank wire transfers (SR VII); put in place measures to prevent the abuse of NPOs by terrorist financiers (SR VIII); and institute measures to detect cross-border movements of cash (SR IX).⁷⁶

⁷² FATF, IX Special Recommendations (n 1).

⁷³ Turner (n 12) 557.

⁷⁴ Ben Hayes, ‘How International Rules on Countering the Financing of Terrorism Impact on Civil Society’ (Policy briefing for the Transnational Institute 8 May 2013).

⁷⁵ FATF, History of the FATF (n 8).

⁷⁶ FATF, IX Special Recommendations (n 1).

The FATF revised the recommendations in 2012 and integrated terrorist financing with the money laundering measures, aiming to provide greater clarity to the guidance.⁷⁷ This resulted in 40 re-numbered recommendations, including a new measure concerning the proliferation of weapons of mass destruction (Recommendation 7) to encourage countries to implement targeted financial sanctions, as directed by the UNSC.⁷⁸

The terrorist financing recommendations were thus subsumed into the new 40, rather than additional to them. There remained however, a discrete section encompassing both terrorist financing and financing of proliferation (recommendations 5-8) urging countries to criminalise terrorist financing, institute regimes of targeted financial sanctions relating to both terrorist financing and proliferation and, with regard specifically to NPOs, to ‘review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism’, (Recommendation 8). This recommendation survived the review as one of only four specifically addressing terrorist financing, thus signalling that the sector continued to be a cause for concern for the FATF.

There is no binding obligation for the measures to be enforced; the UNSC refrained from adopting a chapter VII Resolution ordering such enforcement, but ‘strongly urged’ members to do so in UNSC 1617.⁷⁹ The standards, established in haste in response to exceptional circumstances and, according to Hayes, in the absence of democratic oversight, were thus embedded on a permanent basis.⁸⁰

The recommendations were targeted at NPOs as well as some of the structures that they may use in order to carry out their operations. The increased focus on

⁷⁷ FATF, ‘International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation: The FATF Recommendations’ (FATF/OECD 2012 - updated June 2019).

⁷⁸ *ibid.*

⁷⁹ UN Doc. S/Res/1617 (2005) 29/7/2005 Para 7.

⁸⁰ Hayes (n 74).

financial services such as banks, and various measures that NPOs may use to transfer funds (IVTS, wire transfers and the use of cash, for example) could potentially affect the way they were able to carry out their business.

4.2.2 Some consequences of non-cooperation

The FATF has other broad programmes on which it focuses, including what it classifies as high risk and non-cooperative jurisdictions (HRNC).⁸¹ The power and control the FATF wields emanates both from this system of blacklisting and its programme of mutual evaluations, in which compliance with the recommendations is assessed. In the following section these aspects of FATF influence and, according to some commentators, its overreach, will be considered.

It was increasingly recognised, with regard to global standards, 'the system was only as strong as the weakest link in the chain'; criminals would redirect their finances through jurisdictions with lax standards and purposefully avoid countries with stringent AML policies.⁸² This sentiment came to include terrorist financing after 2001 when the FATF expanded its recommendations.

The FATF introduced a major project in 1999 to identify non-compliant countries as 'non-cooperative countries and territories' (NCCTs). The initiative aimed to 'secure the adoption by all financial centres of international standards to prevent, detect and punish money-laundering, and thereby effectively co-operate internationally in the global fight against money laundering'.⁸³ According to Sharman, the basic aim of the process, however, was to considerably extend the coverage of the international AML regime beyond the wealthy country members.⁸⁴ Each country's financial environment was scrutinised to identify detrimental rules and practices, for example; inadequate

⁸¹ Formerly 'non-cooperative countries and territories' (NCCTs).

⁸² Sharman (n 13) 641.

⁸³ FATF, 'Annual Review of NCCTs 2006-07' (FATF/OECD 2007) 2.

⁸⁴ Jason Sharman, *The Money Laundry: Regulating Criminal Finance in the Global Economy* (Cornell University Press 2011) 129.

supervision of financial institutions and lack of available resources to adequately conduct investigations.⁸⁵

Most countries cooperated in this process by making available information on their laws and financial regulations and forty-seven nations were identified as meriting review, of which fifteen were identified as 'non-cooperative', having 'serious, systemic money laundering problems.'⁸⁶ The effective blacklisting of these jurisdictions, according to Sharman proved surprisingly successful in promoting compliance, given that the FATF lacked universal authority and coercive options. He argues that the dissemination of AML policies, particularly in the developing world, were based on the exercise of power-based mechanisms rather than voluntary adoption by countries as a result of rational learning or rational response to incentives.⁸⁷

Four causal mechanisms have been advanced by scholars explaining why similar policies are adopted by states (with apparently very little in common) at the same time: lesson drawing, coercion, mimicry and competitions effects.⁸⁸ Sharman considers the focus was on the latter three mechanisms, in combination, to bring about change. The initial blacklisting of 15 countries (including The Bahamas, Cayman Islands, Israel and Lebanon) served as a warning to others to institute AML policies, as those on the list felt the economic effects. Many international banks for example severed correspondent banking links with counterparts in the Eastern Caribbean to avoid the stigma of associating with blacklisted jurisdictions.⁸⁹

Blacklisting damaged the reputation of targeted countries, affecting their interface with financial institutions and potentially affecting every internationally connected sector: remittances from abroad, tourism and the

⁸⁵ FATF, 'Report on Non-cooperative Countries and Territories' (FATF/OECD 14 February 2000).

⁸⁶ FATF, 'Review to Identify Non-cooperative Countries and Territories: Increasing the Worldwide Effectiveness of Anti-money Laundering Measures' (FATF/OECD 2001) 3-4.

⁸⁷ Sharman (n 13) 644.

⁸⁸ Beth Simmons, Frank Dobbin and Geoffrey Garrett, 'Introduction: The International Diffusion of Liberalism' (2006) 60 (4) *International Organization* 781.

⁸⁹ Sharman (n 13) 654.

flow of new investment. This precipitated capital flight, which in turn had serious implications for the countries' economic activity.⁹⁰ The FATF urged financial institutions to apply Recommendation 21 to NCCTs, in that they should 'give special attention to business relations and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply these Recommendations.' Thus, being subject to this 'special attention' caused considerable reputational damage, and negative economic consequences.⁹¹

Although this system has been replaced by the more discriminatory HRNC regime, the list is more fluid and labels more jurisdictions as 'high risk' than its predecessor, particularly in the five years to 2015.⁹² The FATF maintain that public identification as 'high risk' provides the impetus for non-cooperative countries to reform.⁹³ This also acts as an indicator to the banking sector that dealings within this jurisdiction could be risky to their business, and thus may influence the banks perception of risk and the potential reputational cost attached.

Pakistan is currently being urged by the FATF to rectify the strategic deficiencies noted in June 2018 when it was found, for example, to have; insufficient understanding of the terrorist financing risks posed by terrorist groups including Al-Qaeda and IS; its failure to take action on the illicit movement of currency; and deficiencies in its financial sanctions regime.⁹⁴ The country risks being blacklisted if sufficient progress is not made to the satisfaction of the FATF. The serious financial ramifications of this have been estimated by the Foreign Minister to amount to an annual loss of \$10 billion.⁹⁵

⁹⁰ Sharman (n 84) 110.

⁹¹ FATF Annual Review of NCCTs 2006-2007(n 83).

⁹² Ramachandran and others (n 26) 256.

⁹³ FATF, 'Improving Global AML/CFT Compliance: Ongoing Process' (FATF/OECD 22 February 2019)

⁹⁴ Ibid.

⁹⁵ Dipanjan Chaudhury, 'Pakistan Risks Losing \$10 Million Annually Following FATF "Grey List"' (*The economic Times*, 3 April 2019)

<https://economictimes.indiatimes.com/news/international/world-news/pakistan-risks-losing-10-billion-annually-following-fatf-grey-list/articleshow/68697831.cms> accessed 1 March 2020.

The concept of “mimicry”, rather than status enhancement, drives policy adoption, for some states. Governments dread ‘the stigma of backwardness and therefore eagerly adopt policy innovations regardless of functional need’ especially if others are seen to be doing likewise.⁹⁶ The mechanism of competition has also led countries to adopt AML/CTF policies in order to appear more attractive to investors. If a critical mass of countries has adopted measures, there is increased pressure to do likewise: it would be harder for a country to attract investment and transact with the international community relative to its compliant neighbours.⁹⁷

The FATF in effect called into question the legitimacy of the blacklisted countries to operate as financial centres. Johnson suggests that, with no formal mandate to compel compliance, the NCCT initiative operated on an informal level.⁹⁸ The fairness of the FATF regime also concerned some commentators, especially in the earlier years, with unevenness of pressure exerted particularly on smaller states at the behest of more powerful ones, which caused profound resentment.⁹⁹

The impact of this regulatory involvement can be significant, with banks acquiring more authority to discern where the risk lies, in accordance with the risk-based approach promulgated by the FATF, and to allocate resources accordingly.¹⁰⁰ This could result in directing monitoring resources to areas of high risk, or possibly to a decision to exit a particular relationship if the risk is deemed too high. Thus, banks may de-risk by scaling back doing business with a whole nation’s banking sector and, as discussed in Chapter Five, the question of

⁹⁶ Kurt Weyland, ‘Theories of Policy Diffusion: Lessons from Latin American Pension Reform’ (2005)57(2) *World Politics* 262, 270.

⁹⁷ Sharman (n13) 653.

⁹⁸ Jackie Johnson, ‘Repairing Legitimacy After Blacklisting by the FATF’ (2003) 7 (1) *Journal of Money Laundering Control* 38, 40.

⁹⁹ William Allen, ‘The War Against Terrorism Financing’ (2003)6(4) *Journal of Money Laundering Control* 306, 307: Also described as ‘a non-universal body seeks to enforce non-binding standards on non-member countries’ Jae-Myong Koh, *Suppressing Terrorist Financing and Money Laundering*

¹⁰⁰ FATF, ‘Guidance on the Risk-based Approach to Combating Money Laundering and Terrorist Financing’ (FATF/OECD 2007).

risk has become relevant to whole sectors, including the NPO sector, as well as to individual NPOs.

4.2.3 Legitimacy of the FATF

The FATFs influence, as evidenced above, is thus considerable. Hayes summarises the situation just six weeks post 9/11; ‘...the UN and FATF had extended the global framework devised to combat money laundering to terrorist financing, mandated an elaborate global terrorist blacklisting system and put the surveillance of the not-for-profit sector firmly onto the counter-terrorism agenda’.¹⁰¹ The FATF’s influence comes from the creation of ‘soft law’ in the form of non-binding rules, and in creating incentives for states to collaborate. These rules also create an expectation of future compliance.¹⁰² This creation of soft law may have some advantages in that it has helped to create a practical and efficient means of addressing a collective problem and building a global consensus, resulting in compliance with respect to the prescribed standards.¹⁰³ Cooper also notes that bodies such as the IMF and World Bank have, through their support and endorsement given force to ‘unenforceable soft law standards’.¹⁰⁴ The method of evaluating performance, as illustrated below, is established in its programme of mutual evaluations, from which it also derives power and exerts influence over the way governments regulate civil society.¹⁰⁵

The NCCT initiative challenged the legitimacy of the relationship between financial institutions and their clients and regulators, usurping this role. The

¹⁰¹ Hayes (n 74) 2.

¹⁰² Michael Pucci, ‘FATF Recommendations : Becoming Soft Law’ Vol 37 MJIL opinion piece <http://www.mjilonline.org/fatf-recommendations-becoming-soft-law-2/> accessed 1 March 2020.

¹⁰³ Turner (n 12).

¹⁰⁴ Karen Cooper, ‘Counter-terrorism Finance, Precautionary Logic and the Regulation of Risk: The Regulation of Informal Value Transfer Systems Within the UK’ in King, Walker and Gurulé (eds) (n 26) 1037.

¹⁰⁵ Kay Guinane, ‘The International Anti-terrorist Financing System’s Negative Effect on Civil Society Resources’ (State of Civil Society Report-Guest Essay 2015) http://www.civicus.org/images/SOCS2015_ESSAY9_AntiTerroristFinancingEffectsOnCS.pdf accessed 1 March 2020.

countries concerned did not consider the FATF capable of bestowing legitimacy; the FATF, according to Johnson, assumed that role itself. 'Power on its own cannot guarantee authority unless the power in itself is considered to be legitimate.' The growing number of states and organisations wishing to become aligned with the goals and objectives of the FATF conferred the organisation with ever increasing legitimacy.¹⁰⁶ The new open-ended mandate of the FATF will serve to enhance its status and influence as a policy-making body.¹⁰⁷

5. NON-PROFIT ORGANISATIONS WITHIN THIS NEW LEGAL LANDSCAPE

5.1 Sector-specific issues relating to the regulatory framework

The non-profit sector, identified as susceptible to exploitation for the purpose of terrorist financing, as discussed in Chapter Three,¹⁰⁸ thus became a focus of attention for the FATF.¹⁰⁹ Countries are thereby urged to review their laws and regulations in this regard, and to undertake appropriate scrutiny and supervision of non-profit activity. This assertion of the particular vulnerability of the sector was made, according to some commentators, with no or very little empirical evidence to justify such a claim.¹¹⁰

The FATF outlines its expectations for compliance within two key publications; the binding 'Interpretive Note', expanding on the recommendation, outlining its objectives and principles and the measures countries should undertake,¹¹¹ and the non-binding 'Best Practices Paper', updated periodically, outlining proposals

¹⁰⁶ Johnson (n 98) 40.

¹⁰⁷ FATF, 'Ministers Give FATF an Open Ended Mandate' (FATF Ministerial Declaration 12 April 2019) <https://www.fatf-gafi.org/media/fatf/content/images/FATF-Ministerial-Declaration-Mandate.pdf> accessed 1 March 2020.

¹⁰⁸ Section 3.2.2.

¹⁰⁹ FATF SR VIII became Rec. 8 when the International Standards were revised in 2012 and will be referred to as Rec. 8 hereafter for the sake of consistency.

¹¹⁰ Romaniuk and Keatinge (n 14) 268; Ibrahim Warde, *The Price of Fear: Al-Qaeda and the Truth Behind the Financial War on Terror* (I B Tauris 2007) ch 9.

¹¹¹ FATF, 'The FATF Recommendations 2012-2019' (n 24) 52 (Interpretative Note to Recommendation 8: Non-profit Organisations).

for compliance.¹¹² Starting with a domestic review of the NPO sector, the measures required encompass; outreach concerning TF issues; supervision/monitoring; investigation and intelligence gathering; and international cooperation.¹¹³ The outreach measures include the establishment of clear policies promoting transparency in the administration of NPOs, developing best practices to address TF risks and encouraging NPOs to use regulated financial channels for their financial transaction.¹¹⁴

The early incarnations of the interpretive notes and best practise papers have been criticised for setting a general standard for internal governance rather than focusing on addressing governments, and for emphasising generic aspects of the work that NPOs pursue without providing context or evidence in support of this. FATF guidance, thus invited a tough regulatory response whilst reinforcing the widely held view which was prominent in the post 9/11 era, that NPOs, in particular Muslim ones should be viewed with suspicion.¹¹⁵

To fulfil their monitoring requirements countries are expected to ensure, for example, that NPOs in their jurisdiction; are licensed or registered; maintain publicly available information regarding their charitable purpose and who controls their activities; issue detailed financial accounts; and utilise funds in a manner consistent with their charitable purpose, thus requiring strict reporting and vetting measures.¹¹⁶

Compliance with each of the recommendations is measured through the 'mutual evaluation' process whereby peer evaluators assess member states' compliance according to established procedures. Extensive reports are compiled as a result of the evaluation visits, and states are assessed on a scale and given one of four ratings: compliant, largely compliant, partially compliant or non-compliant,

¹¹² Most recently: FATF, 'Combating the Abuse of Non-profit Organisations (Recommendation 8)' (FATF/OECD June 2015) 4 and taking into account published typologies such as: FATF, 'The risk of Terrorist Abuse in Non-profit Organisations' (FATF/OECD June 2014).

¹¹³ FATF, Interpretive Note to Recommendation 8 (n 112) 55.

¹¹⁴ *ibid* 56.

¹¹⁵ Romaniuk and Keatinge (n 14) 269.

¹¹⁶ FATF, Interpretive Note to Recommendation 8 (n 113) 56.

which describe a range of situations from no shortcomings to one of major shortcomings in regulatory compliance.¹¹⁷

5.1.1 A question of compliance-Recommendation 8

In order to assess compliance with Recommendation 8 (Rec.8), the mutual evaluation reports of 159 countries undertaken from 2005 to 2011 were examined and the report, published in 2012, revealed that 85% were rated either non-compliant or only partially compliant,¹¹⁸ suggesting major deficiencies with the Recommendation or with the states' commitment to it.

Having analysed the compliance ratings for several of the other recommendations, Shillito concluded that the low rate of compliance was not atypical; the non-financial sector recommendations, for example those pertaining to wire transfers (Rec.16) and MVTs, (Rec.14) in general had even lower levels of compliance. Compliance with the more fundamental and established recommendations, for example those making reference to a risk-based approach (Rec. 1) and international instruments (Rec.36) have much higher levels of compliance.¹¹⁹ This may be indicative of the FATFs lack of expertise in certain areas and that their main focus has historically been on the financial sector.

Some of the surprising results of the assessment process (between 2005 and 2011) included the awarding of the top compliance ratings for only five countries including Egypt and Tunisia, as both receive regular criticism for their relationship with their domestic non-profit sector. Saudi Arabia, again with its well-publicised tolerant stance toward financing mechanisms of charities was assessed as being 'largely compliant.'¹²⁰

¹¹⁷ FATF, 'Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems' (FATF/OECD updated 2018) 11-12.

¹¹⁸ Ben Hayes, 'Counter-terrorism "policy laundering" and the FATF: Legalising Surveillance, Regulating Civil Society' (Transnational Institute/Statewatch 2012) 29-30.

¹¹⁹ Matthew Shillito, 'Countering Terrorist Financing via Non-profit organisations: Assessing Why Few States Comply with the International Recommendations.' (2015) 6 (3) Nonprofit Policy Forum 325, 350-351.

¹²⁰ Romaniuk and Keatinge (n 14).

The FATF, via the interpretative notes to the recommendations urge countries to ensure they have adequate investigative powers and resources at their disposal to examine NPOs suspected of being exploited by terrorists, and the means to disseminate information, where appropriate, to other organisations and appropriate authorities in this regard.¹²¹

5.1.2 Unintended consequences- restrictions on NPOs' operations

States could potentially use the guidance to justify intrusive and spurious investigations and create a restrictive environment in which NPOs may operate. There have been numerous examples of states passing legislation which has had seriously consequences for the non-profit sector in the pursuit of higher compliance ratings or used as a deliberate excuse for draconian laws to be passed to restrict freedom of speech. A human rights group, analysing 35 country case studies, for example, observed that states have at their disposal 'a sophisticated arsenal, and restrictive legal, administrative or practical measures are less visible than other forms of human rights abuse, and therefore less likely to incite international condemnation" and concluded that AML/CTF legislation was being used as a tool of repression by authorities to 'neutralise NGOs and silence critics'.¹²²

The FATF-style regional body of the Middle East and North Africa (MENAFATF) commented that the regulation of the NPO sector under review in Tunisia was 'very strict and highly restrictive', and effectively allows wide discretion to blacklist certain groups, including those involved in promoting human rights and democratic principles, by refusing to grant them the required license to operate.¹²³ The country has undergone a further mutual evaluation in 2016 and placed in the enhanced follow up process; FATF retains an element of control, and evaluators can monitor progress in areas where compliance is weak (for

¹²¹ FATF, Interpretive Note to Recommendation 8 (n 113) 57-58.

¹²² The Observatory for the Protection of Human Rights Defenders (OBS), 'Violations of the right of NGOs to Funding: From Harassment to Criminalisation' (OBS 2013) 7-8.

¹²³ Hayes (n 118).

example with Rec. 8). Since the 2011 revolution in Tunisia though, the voice of civil society groups has grown in prominence and have been instrumental in calling for protection for freedom of association and an independent civil society sector.¹²⁴

5.1.3 A case for greater involvement in policymaking

There has been a wider movement for the NPO sector to become more involved in the regulation that affects the sector and to encourage greater accountability and transparency from the FATF. The UK National Council for Voluntary Organisations (NCVO), for example, convened an advisory group, which concluded that FATF measures had evolved without inviting engagement with the sector. Consequently, measures could be counter-productive and misrepresent the sector as being ‘part of the problem, not part of the solution’.¹²⁵

The first formal engagement with civil society groups took place in 2013 when participation was invited by means of a formal consultation with the FATF.¹²⁶ The Transnational NPO working group on FATF proposed reforms regarding proportionality of approach and a targeted approach to the regulation in response to concerns about the effect that implementation of Rec.8 was having on the sector. There were concerns, however, that a later draft Best Practice paper was not widely circulated, thus limiting participation and engagement and calling into question the desire from the FATF to be transparent and inclusive.¹²⁷

The FATF’s current 4th round of evaluations is based on a revised methodology, taking into account the effect of implementation as well as the previously

¹²⁴ The International Center for Not-for-Profit Law, (ICNL) ‘Civic Freedom Monitor: Tunisia’ 17 May 2019.

¹²⁵ Nola Quigley and Belinda Pratten, ‘Security and Civil Society: The Impact of Counterterrorism Measures on Civil Society Organisations’ (NCVO 11 January 2007) 7.

¹²⁶ Guinane (n 105).

¹²⁷ Oonagh Breen, ‘European Non-profit oversight: The case for Regulating From the Outside In’ (2015) 91(3) Chicago Kent Law Review 991, 1016.

measured technical compliance. Amongst the core issues to be considered would be ‘To what extent, without disrupting or discouraging legitimate NPO activities, has the country applied focused and proportionate measures to such NPOs which the country has identified as being vulnerable to terrorist finance abuse in line with the risk-based approach?’¹²⁸ Thus, proportionality and targeting of resources is encouraged as well as a focus on the possible negative effects that regulation may be having on charities.

As a result of pressure from the sector for greater inclusion in policymaking, the FATF now stages an annual formal consultation with the private sector, to which four seats are offered to NPO sector representatives. This provides an opportunity for discussion on topics of mutual concern to private sector stakeholders, which include representatives from the financial services sector.¹²⁹ Matters such as bank de-risking and the challenges for NPOs can therefore be aired. The importance of involving the charity sector in policy issues was identified by certain groups of interviewees, discussed further in Chapter Six.¹³⁰

5.1.4 Negative effects on the NPO sector of CTF policy

The non-profit sector has been subjected to intense scrutiny in the US in the post-9/11 era; the strategy to freeze assets of suspected terrorists has been particularly controversial with respect to domestically based Islamic charities. The US Treasury has justified this focus by claiming that investigations have revealed abuse within the sector, particularly through the diversion of funds donated for the purpose of humanitarian aid.¹³¹

In the 2015 national risk assessment of terrorist financing the Treasury reported that around 20% of the overall observed methods of fundraising for

¹²⁸ FATF, ‘Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems’ (FATF/OECD 2013 updated 2018) 118.

¹²⁹ FATF, ‘Private Sector Consultative Forum, Vienna 23-24 April’ (FATF/OECD 2019) 9.

¹³⁰ Section 4.4.

¹³¹ US Department of the Treasury, ‘Anti-terrorist Financing Guidelines: Voluntary Best Practices for US based Charities’ (2005) 2-3.

terrorist organisations derived from charitable organisations, and a total of 54 charities were on the list of designated terrorist organisations the previous year.¹³² Muslim charities have been disproportionately affected by the measures taken in the US to counter terrorist finance, and have seen decreased levels of donations as a consequence.¹³³

Several major US based Muslim charities such as Benevolence International and the Holy land Foundation were designated in 2001, and 26 others have similarly been designated as terrorist organisations, and as such had their assets frozen.¹³⁴ Warde maintains that all Muslim charities in the US were under a veil of suspicion in the aftermath of 9/11. Whilst accepting that reform in this sector was both necessary and overdue, the financial irregularities that afflicted NPOs of all kinds assumed more sinister characteristics when associated with Muslim charities, with exaggerated claims or fabricated links to terror causing sensationalist headlines and damage to the reputation of many charities.¹³⁵ This theme will be discussed in later chapters in the analysis of the empirical data.

The evidential basis for many of the charges of terrorism brought against Muslim charities was not made public, US prosecutors having withheld this information, which has attracted criticism. Leading academics concluded that the policy of freezing assets is ineffective in the circumstances, due to easy access to alternative funding streams. It is suspected therefore that the motivation for this policy stance derives from a desire to be seen to be acting, rather than any conviction that the financing of terrorism would be seriously diminished as a result.¹³⁶

Not only were donations effected by this focus on Muslim charities, which affected the number of people these organisations could help, but it also meant that informal channels were more likely to be used to meet their charitable

¹³² US Department of the Treasury, 'National Terrorist Financing Risk Assessment (2015) 36.

¹³³ Elizabeth Bloodgood and Joannie Tremblay-Boire, 'International NGOs and Regulation in an Age of Terrorism' (2011) 22 *Voluntas* 142, 153.

¹³⁴ Ryder (n 39) 83-84.

¹³⁵ Warde (n 110) 149.

¹³⁶ Ryder (n 39) 84.

objectives. There were missed opportunities to engender support amongst those who could assist in reducing the terrorist threat, when instead discriminatory policies seriously risked antagonising them.¹³⁷

According to Bloodgood and Tremblay-Boire the negative effects of regulation have been felt most acutely amongst INPOs in Germany, compared to the other countries reviewed (USA, Canada, UK and Japan) where law enforcement agencies have enhanced powers of surveillance and the power to dissolve NPOs.¹³⁸ This has also been the position in the US, where NPOs have been immediately dissolved upon scant evidence, without having the opportunity to state their case.¹³⁹ Additionally, in common with the USA, court challenges have been brought in Germany and there have been accusations of targeting of groups with a political mission, with disproportionate measures used against NPOs on the basis of scant evidence of any terrorist links, and lack of transparency with respect to matters of enforcement.¹⁴⁰

The burden of the abovementioned US Treasury guidelines, intended to prevent diversion of funds sent overseas, has been felt by many major international charities such as Oxfam America. The unrealistic due diligence requirements and the spectre of investigation and even prosecution, for example, if there is unwitting 'material support' given to terrorist groups overseas in the distribution of aid, has had a chilling effect on the work some humanitarian charitable organisations have been willing to undertake.¹⁴¹

For some US Muslim charities too, this chilling affect has been profoundly felt. According to some commentators this has affected the 'free and full exercise of their religion through charitable giving.'¹⁴² Zakat, as previously discussed in

¹³⁷ Warde (n 110) 181-182.

¹³⁸ Bloodgood and Tremblay-Boire (n 133) 166.

¹³⁹ OBM Watch/Grantmakers Without Borders, 'Collateral Damage: How the war on Terror Hurts Charities, Foundations and the People they Serve' (July 2008) 77.

¹⁴⁰ Bloodgood and Tremblay Boire (n 133).

¹⁴¹ Mark Sidel 'Choices and Approaches: Anti-terrorism Law and Civil Society in the United States and the United Kingdom after September 11' (2011) 61 University of Toronto Law Journal 119.

¹⁴² American Civil Liberties Union (ACLU), 'Blocking Faith, Freezing Charity: Chilling Muslim Charitable Giving in the War on Terrorism Financing' (June 2009)14.

Chapter 3 (s.3.2.2) constitutes a religious obligation and fundamental to the practice of the Islamic faith. Crimm also notes the effect on charitable giving and the lack of any safe vehicle through which donations to Muslim charities could be made. This could possibly allay the fears that they may be committing an offence which could result in their assets being frozen and a criminal charge made.¹⁴³ The impact of the regulation on charities in the domestic jurisdiction is evaluated in the analysis of the interview data in the forthcoming chapters, and comparisons made with the approach taken in jurisdictions such as the US.

5.2 Wider issues affecting the NPO sector

5.2.1 The struggle for a definition

A) *Differences in approach*

Clunan notes the difference in approach between the EU and the US, which emanates from a fundamental disagreement in definition of the problem of counter-terrorist finance. The EU was more concerned with its members implementing rigorous domestic counter-terrorist finance legislation and enhancing technical assistance and global standard setting as advocated by the FATF. There was however less appetite for designations of individuals and entities and for asset freeze.¹⁴⁴ This was especially apparent after early errors in listing, concerns regarding evidence and lawsuits in Europe, for example the Kadi I case with reference to the sanction regime.¹⁴⁵

Credibility of the sanctions system depends on it being fair and legitimate. The CTITF report highlights several problems encountered by countries, which effects compliance, and consequently global compliance remains weak. The legal framework required to immediately freeze assets may be absent or the

¹⁴³ Nina Crimm, 'Muslim Americans Charitable Giving Dilemma: What about a Centralized Terror-free Donor Advised Fund?' (2008) 13(2) Roger Williams University Law Review 375,379.

¹⁴⁴ Clunan (n 6) 581.

¹⁴⁵ Joined cases C-402/05 and C-415/05, Kadi v Council, [2008] E.C. RI-06351 (Kadi I).

capability to do so lacking. UNSCR 1373 requires the state to determine whose assets are to be frozen and for them to share intelligence, both of which can be problematic.¹⁴⁶

The UN therefore has an active involvement in all aspects of terrorist financing, through its subsidiary organs and through collaboration with international organisations such as the International Monetary Fund (IMF).

Whilst each may focus on the use of finance for terrorism within its own field, there has been criticism of the ability of agencies to coordinate their efforts effectively. Some of the possible reasons for this may include; no single definition of terrorism; language barriers; no overall coordination of activities by the SC and lack of a central database on terrorist financing.¹⁴⁷

The lack of a single agreed definition of terrorism has had consequences in other areas and there is much academic debate as to whether this is truly problematic, and the practical consequences attached to this.

B) *Absence of a universally accepted definition*

There is no universally accepted definition of terrorism. Those resisting oppression may be regarded as freedom fighters, as well as those struggling for the realisation of self-determination, whilst others may label them 'terrorists.' Nelson Mandela, for example had been regarded as both.¹⁴⁸ All definitions of terrorism are by their very nature subjective.¹⁴⁹ Despite the apparently intractable problem of lack of a comprehensive definition of what constitutes terrorism,¹⁵⁰ the UN mandated that member states take proactive steps to

¹⁴⁶ CTITF Report 2009 (n 16) ch 6 19-20.

¹⁴⁷ Omer Elagab, 'Control of Terrorist Funds and the Banking System' (2006) 21 (1) Journal of International Law and Banking Regulation 38, 44.

¹⁴⁸ Sorel (n 10) 366-367.

¹⁴⁹ Many commentators consider that the concept defies definition: Jason Burke, *Al-Qaeda: The True Story of Radical Islam* (Penguin 2007) 22: or that its utility lies in its descriptive value, having no juridical meaning: Rosalyn Higgins, 'The General International Law of Terrorism' in Rosalyn Higgins and Maurice Flory (eds), *Terrorism and International Law* (1997) 13.

¹⁵⁰ The UNGA did however adopt by consensus a definition describing acts considered to be terrorist in nature: A/RES/49/60 UNGA Measures to Eliminate International Terrorism 9 November 1994.

combat terrorism, including freezing funds and increasing criminalisation for terrorist acts.¹⁵¹ The UN has urged states, through its various instruments to cooperate in the harmonisation of national laws. In the absence of a definition of what constitutes a terrorist act, which may be criminalised as such, the realisation of international cooperation becomes infinitely less attainable, especially where national self-interest and political rather than legal considerations prevail.¹⁵²

States have to define the parameters of terrorism to make clear who will be subject to possibly harsher penalties and diminished rights protections that can be associated with the terrorist designation. Furthermore, the label 'terrorist' in different countries carries different consequences and can have a very significant effect on those concerned, for example being subject to an asset freezing order and being barred from entry to the US.¹⁵³ Defining terrorism according to self-interest may result in double-standards; the US government, for example, enlisted the support of the Northern Alliance against the Taliban in Afghanistan post 9/11, a group which had committed atrocities which could be classified as terrorist acts against civilian groups. This behaviour is facilitated by the absence of a universally accepted definition.¹⁵⁴ This aligns with Sorel's view that the description of terrorist behaviour becomes a social judgment, and consequently risks being usurped by powerful nations defining the international order to suit their notions of how this should be.¹⁵⁵ The Kurdish Workers party (PKK) has been designated a terrorist organisation by many countries, including the US and its allies. The same states though have recently trained and armed branches of this group against IS in what Charles Lister describes as a political move; 'We designated them for political reasons, but we also chose to ignore the designation for political reasons.'¹⁵⁶

¹⁵¹ UN Doc. S/RES/1373 (2001).

¹⁵² Eva Herschinger, 'A Battlefield of Meanings: The Struggle for Identity in the UN Debates on a Definition of International Terrorism' (2013) 25 *Terrorism and Political Violence* 183, 184-185.

¹⁵³ Sudha Setty, 'What's in a Name? How Nations Define Terrorism 10 years after 9/11' (2011) 33(1) *University of Pennsylvania Journal of International Law* 1, 3-7.

¹⁵⁴ Anthony Richards, *Conceptualizing Terrorism* (OUP 2015) 27.

¹⁵⁵ Sorel (n 10) 370.

¹⁵⁶ Charles Lister, (Middle East Institute) quoted in Tracey Shelton, 'What is Terrorism? The Controversial label that is used and abused around the World' (*ABC News*, 3 August 2018).

A lack of consensus may affect the ability of a state to address the threat of terrorism, as what actually constitutes a terrorist, a terrorist group or a terrorist offence is unclear. Consequently, this presents difficulties in defining terrorist finance as a distinctive form of criminal activity.¹⁵⁷ Schmid considers that the distinction between freedom fighters and terrorists could be made by granting the former special treatment if they abide by the rules of war and that a narrow and precise definition would attract wider support.¹⁵⁸ Other academic analysts point to the extreme difficulty in reaching a consensus on such an abstract notion involving a wide variety of 'politically driven violence aimed at achieving publicity'.¹⁵⁹

There are numerous examples where the practical implications of the lack of agreed definition becomes apparent. Terrorists groups may be designated as a terrorist organisation in one country but not another, for example, HAMAS. Designated as such in the US but recognised as a legitimate resistance movement in Iran,¹⁶⁰ and by China as the elected representatives of the people of Palestine.¹⁶¹ Banks, charities and other organisations risk financial penalties, in the case of banks, or closure in the case of US charities if found to be associated with designated persons or organisations. The Jordanian Arab bank, for example, embroiled in a civil case with respect to alleged association with Hamas,¹⁶² and HSBC in 2012 fined for failures which allowed terrorists access to

<https://www.abc.net.au/news/2018-07-21/how-the-word-terrorism-is-used-and-misused-across-the-globe/9862124> accessed 1 March 2020.

¹⁵⁷ Mark Pieth, 'Criminalizing the financing of Terrorism' (2006) 4 *Journal of International Criminal Justice* 1074, 1079.

¹⁵⁸ Schmid (n 2) 95.

¹⁵⁹ Leonard Weinberg, Ami Pedahzur and Sivan Hirsch-Hoefler, 'The Challenges of Conceptualizing Terrorism' (2004) 16(4) *Terrorism and Political Violence*.

¹⁶⁰ Reuters, US fails to win enough support at UN to condemn Hamas (*China Daily*, 7 December 2018) <https://www.chinadailyhk.com/articles/174/103/246/1544152560223.html> accessed 1 March 2020.

¹⁶¹ Daoud Kuttab, China pledges support for Palestinians but leaves the door open to Israel *The New Arab*, 19 July 2017) <https://www.alaraby.co.uk/english/indepth/2017/7/19/abbas-seeks-out-chinese-support-for-palestine-1> accessed 1 March 2020.

¹⁶² Stephanie Clifford, 'Arab Bank Reaches Settlement in Suit Accusing it of Financing Terrorism' (*New York Times*, 14 August 2015) <https://www.nytimes.com/2015/08/15/nyregion/arab-bank-reaches-settlement-in-suit-accusing-it-of-financing-terrorism.html> accessed 1 March 2020.

the financial system.¹⁶³ The Holy Land Foundation, mentioned previously, was one of the many US NPOs closed for alleged links with terrorism, although the organisation denied throughout the lengthy investigations any links with Hamas. The evidence presented was considered to have been based on falsified or misleading information, which led to the conviction and imprisonment of several individuals involved with the organisation.¹⁶⁴

Individuals may also be committing a criminal offence with respect to terrorist financing if funds are diverted through charities to those subject to an asset freeze. NPOs therefore rely on the formal categorisation of groups as terrorists, or their acceptance as legitimate resistance groups within a certain jurisdiction; the question of definition is therefore significant. Knowing which groups or individuals are designated in which jurisdiction is a critical factor in due diligence practices. It is incumbent upon organisations such as NPOs to carry out due diligence on those with whom they have dealings to ensure they do not contravene domestic legislation or the legislation in other jurisdictions in which they may seek to operate.

The Islamic Association of Sweden and the think tank The Cordoba Foundation are amongst several international groups designated as terrorist organisations in the United Arab Emirates in a move incomprehensible to those affected, although the motive is recognised by some as an attempt to silence dissent.¹⁶⁵ The charity Interpal is designated as a terrorist group in the US and Australia but is a registered UK charity. The fundraising platform JustGiving was recently accused of ‘acting in breach of US and Australian legislation’ for providing a

¹⁶³ Jill Treanor and Dominic Rushe, ‘HSBC Pays Record \$1.9bn Fine to Settle US Money Laundering Accusations’ (*The Guardian*, 11 December 2012) <https://www.theguardian.com/business/2012/dec/11/hsbc-bank-us-money-laundering> accessed 1 March 2020.

¹⁶⁴ Warde (n 110) 144; Miko Peled, *Injustice: The story of the Holy Land Foundation Five* (Just World Books 2018).

¹⁶⁵ Kirsty Weakley, ‘Islamic Relief Labelled as “Terrorist” Group by UAE’ (*Civil Society*, 11 December 2014) <https://www.civilsociety.co.uk/news/islamic-relief-labelled-as--terrorist--group-by-uae.html> accessed 1 March 2020.

platform for the charity (hosting historic volunteers' fundraising pages).¹⁶⁶

5.2.2 Targeting the banking sector

Post 9/11 the investigation of financial transactions became a crucial element in understanding the intentions of terrorists, which could enable the authorities to track the flow of money and ultimately apprehend would-be perpetrators before the act of terrorism could be committed. Thus, financial transaction data could facilitate the investigation of mere suspicion. CTF policy centred on the notion that 'Knowledge about future risk is *always already present* in the data, if only information on transaction patterns can be effectively integrated and mined'.¹⁶⁷

The pursuit of terrorist financing may also be framed in the wider context of pre-emptive security politics, in that gathering intelligence from money trails in order to predict possible terrorist attacks becomes central to CTF policy.¹⁶⁸ However tensions between the US and EU surfaced when the US Treasury Department introduced an ambitious CTF initiative; the Terrorist Finance Tracking Programme (TFTP) to identify and track suspected terrorists and those who finance terrorism, providing intelligence on terrorist cells plot and conspiracies.¹⁶⁹ Access to the financial database of the Society for Worldwide Interbank Financial Telecommunication (SWIFT), violated Belgian privacy laws and those of the EU, prohibiting data sharing with nations with less stringent privacy laws, such as the US.¹⁷⁰ The EU developed its own initiatives though, in recognition of the importance of both financial and location data,¹⁷¹ and the

¹⁶⁶ John Plummer, 'JustGiving removes Interpal pages after protests from pro-Israeli group' (*Third Sector*, 18 February 2019) <https://www.thirdsector.co.uk/justgiving-removes-interpal-pages-protests-pro-israeli-group/fundraising/article/1526079> accessed 1 March 2020.

¹⁶⁷ Louise Amoore and Marieke de Goede, 'Transactions after 9/11: the banal face of the pre-emptive strike' (2008) 33 (2) *Transactions of the Institute of British Geographers* 173,174.

¹⁶⁸ Marieke de Goede, 'Counter-terrorism Assemblages After 9/11' in King, Walker and Gurulé (eds) (n 26) 758.

¹⁶⁹ David Aufhuaser, 'The War on Terrorism: The Financial Front Council' Speech delivered at the Council on Foreign Relations 10 January 2007.

¹⁷⁰ Patrick Connorton, 'Tracking Terrorist Finance Through SWIFT: When US Subpoenas and Foreign Privacy Laws Collide' (2007) 76 *Fordham Law Review*, 283.

¹⁷¹ Parliament and Council Directive 2006/24/EC on the Retention of Data Generated or Processed in Connection with the Provision of Publicly Available Electronic Communications or

strategic and ideological divide was bridged to some extent with an international agreement in 2010,¹⁷² which became known as SWIFT II.¹⁷³

The vulnerabilities of the financial system, both formal and informal to terrorist financing abuse were highlighted by the FATF Recommendations, many of which are aimed at this sector.¹⁷⁴ For example, banks including correspondent banking relationships, MSBs and IVTS. Banks in particular are in the front line and have been enlisted as security actors, relied upon to undertake rigorous customer due diligence and report suspicious activity. 'Know Your Customer' (KYC) policies were recognised as being critical to CTF initiatives in facilitating identification of terror suspects, as listed by competent authorities. The Wolfsberg Statement highlighted the group's commitment to applying enhanced due diligence in sectors identified as posing a higher risk of being used for terrorist financing, for example IVTSs and to deal only with regulated bodies such as bureau de change, remittance businesses and money transfer agents, which are appropriately registered, again due to their enhanced risk profile.¹⁷⁵ The group also effectively involved itself in monitoring regulation and roles which would normally be undertaken by the regulators.¹⁷⁶

The question of risk, brought into sharp focus in the post 9/11 era has affected the behaviours of organisations within the financial services sector, and those presenting an enhanced risk profile, such as some NPOs, have been directly affected by decisions made by financial institutions to mitigate the risk.¹⁷⁷ There have thus been indirect consequences for NPOs resulting from the imposition of counter-terrorist finance regulation on financial institutions. The issue of banks de-risking is explored with interviewees from the financial services sector and

Services or of Public Communications Networks [2006] OJ L281/40. (Data Retention Directive)

¹⁷² Bulloch (n 22).

¹⁷³ Agreement between the European Union and the United States of America on the processing and transfer of Financial Messaging Data from the European Union to the United States for purposes of the Terrorist Finance Tracking Program [2010] OJ L195/5.

¹⁷⁴ FATF, The FATF Recommendations (n 24).

¹⁷⁵ The Wolfsberg Group, 'Wolfsberg Statement on the Suppression of the Financing of Terrorism' <https://www.wolfsberg-principles.com/publications/wolfsberg-standards> accessed 1 March 2020.

¹⁷⁶ Pieth and Aiolfi (n 18) 362.

¹⁷⁷ Sue Eckert, 'Financial Access for US Nonprofits' (Charity and Security Network 2017) ch 6.

the charity sector where some of the challenges arising from implementation of the regulation are highlighted in Chapter Seven.

5.2.3 The problem of financial exclusion

The FATF takes the view that the risk-based approach promulgated in the 2012 regulations provides a framework for countries to establish a more inclusive financial sector and provide wider access to formal financial systems.¹⁷⁸ In some cases though the opposite is happening, as banks take steps to mitigate their financial crime exposure. De-risking, the practice of reducing exposure to risk, can lead to severance of relationships with correspondent banks and with MSBs in a territory considered high risk, which can cause hardship for individuals and organisations relying on these services, for example, on remittances from family members working overseas.¹⁷⁹

The problems created by banks de-risking will be explored further in Chapter Five, which focusses on the UK and the impact on domestic charities, but there is ample evidence that this practice has had far-reaching effects and unintended consequences. The World Bank reported in 2015 on a survey of de-risking practices in the remittance market in which 54% of Money Transfer operators surveyed confirmed that they had at least one of their accounts closed that year.¹⁸⁰

Organisations carrying out remittance activities as MSBs, have been identified as high-risk banking clients, due firstly to the destination of many of the remittances being in countries considered to be high risk by regulators, and secondly this sub-sector itself is considered to be inherently risky.¹⁸¹ There are many examples of banks exiting these relationships, citing regulatory pressures,

¹⁷⁸ FATF, 'Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion' (FATF/OECD 2013).

¹⁷⁹ Michael Levi M, 'Punishing Banks, Their Clients and Their Client's Clients' in King, Walker and Gurulé (eds) (n 26).

¹⁸⁰ The World Bank, 'Report on the G20 Survey on De-risking Activities in the Remittance Market (World Bank Group 2015).

¹⁸¹ Ramachandran, Collin and Juden (n 26) 224-225.

for example Australia's Westpac Banking Corporation in 2015 ended banking relationships with several remittance companies.¹⁸² Although regulatory pressures were cited, such measures may have been taken for commercial reasons as Westpac reportedly later launched their own remittance service.¹⁸³

The reduction in services as a result of remittance service closures may have a profound effect on a local population. Correspondent banks are also deemed risky by many international banks and, as a consequence, some states have minimal access to banking services from the formal banking sector.¹⁸⁴ This can be problematic for certain categories of customer who are effectively excluded from access to financial services, either in the receipt of remittances from relatives overseas or denied banking services due to a decline in correspondent bank offerings domestically. International humanitarian NPOs may equally encounter difficulties when seeking to transfer funds, if remittance services are depleted, and their programmes could be affected, and vulnerable sections of a community denied assistance, due to limited access to correspondent banking.¹⁸⁵

A recent assault on correspondent banking has been made in the form of a presidential Executive Order, giving OFAC greater powers to restrict the scope of these banking relationships, potentially further limiting financial access for vulnerable groups.¹⁸⁶ Of those adults having no access to the formal financial system, estimated to number 1.7 billion in 2017, many are living in rural areas in developing countries, have low incomes and/or lack the documentation which may enable them to open and account. The number of adults now owning a bank account globally appears to be rising, an increase of 7% in the three

¹⁸² Swati Pandey, 'Westpac Targets Transfer Business after Closing Remitter Accounts' (Reuters 6 May 2015) <https://www.reuters.com/article/westpac-remittances/westpac-targets-transfer-business-after-closing-remitter-accounts-idUSL3N1831BB> accessed 1 March 2020.

¹⁸³ *ibid.*

¹⁸⁴ Levi (n 179) 277.

¹⁸⁵ Michaela Erbenová and others, 'The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action' (IMF June 2016) 6.

¹⁸⁶ 'Modernizing Sanctions to Combat Terrorism' US Presidential Executive Order EO 13886 9 September 2019.

years to 2017.¹⁸⁷

The FATF recognises that financial exclusion can jeopardise the implementation of its own recommendations. Furthermore, an overly cautious approach to AML/CTF regulation can effectively exclude legitimate businesses and individuals from the financial system.¹⁸⁸ Assessments carried out from 2005 to 2011 revealed that most countries introduced a similar approach in fulfilling their AML/CTF requirements, and applied measures indiscriminately across their financial sectors. The resulting over-compliance and associated costs risked alienating potential clients. It was also concluded that new excluded groups resulted from the application of over-zealous regimes.¹⁸⁹ The stringent regulation may therefore deter certain institutions, including NPOs from dealing with these excluded groups. These financially excluded groups may also include those whom humanitarian NPOs may seek to reach. Some of the challenges NPOs could face in attempting to do this, and the decision-making processes which may be involved, for example in deciding which projects are too risky, will be discussed in Chapter Six.

6. CONCLUSION

In the discussion of the pivotal structures of the regulatory framework and its development it is clear that the global AML regime, with the FATF as its central proponent, expanded its influence far beyond drug money-laundering and its effects on financial markets, to encompass terrorist financing.¹⁹⁰ Some of the wider issues which have influenced, and continue to influence, the development of the regulatory framework have been discussed in this chapter. This complex and relatively new regulatory landscape is further complicated, for example, with issues of definition, as states define the parameters of terrorism according

¹⁸⁷ Asli Demirgüç-Kunt and others, 'The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution' (The World Bank Group 2017).

¹⁸⁸ FATF Anti-money Laundering and Terrorist Financing Measures and Financial Inclusion (n 183).

¹⁸⁹ *ibid* 15.

¹⁹⁰ Maria Bergström, 'The Global Anti-Money Laundering Regime and the EU Anti-money Laundering Directives: Prevention and Control' in King, Walker and Gurulé (eds) (n 26) 33.

to their own self-interest. The uncertainty and confusion this may generate could impact on the operations of NPOs either directly, or indirectly.¹⁹¹

The power and influence of the FATF is considerable, having the ability to seriously affect the economic position of small nations. Furthermore, its position and messaging with respect to the vulnerability of the NPO sector to terrorist financing can influence the relationship between other stakeholders. The considerable influence exerted by the FATF recommendations comes from the creation of 'soft law', which can be ambiguous and vague and open to interpretation by individual governments, as highlighted in this chapter. In this way the body devising the regulatory framework can exert influence with minimal accountability.

With respect to the non-profit sector, some consequences of CTF policy decisions, with the potential for restricting the operations of legitimate charitable organisations have also been highlighted in this chapter. Compliance with FATF recommendations have been used as vindication for applying repressive legislative measures, and asset freeze regimes, which have become an integral part of the regulatory framework have influenced where NPOs may operate, and with whom they may have dealings. Groups legally permitted to operate in one jurisdiction may be designated as a terrorist group in another, and organisations such as banks and NPOs, as well as individuals, risk penalties for dealing with designated groups or individuals.

Negative effects have also been felt by Muslim organisations particularly in the US, reportedly operating under a veil of suspicion since the events of 9/11, with unrealistic due diligence requirements placed upon them as a result and the perception by some organisations that the exercise of their religion is curtailed, due to the perception that charitable giving in the form of zakat poses greater risks.¹⁹² This raises the question of whether Muslim charities warrant enhanced

¹⁹¹ For example, directly, as the question of whether charitable funds are being inadvertently diverted to terrorists is unclear, and indirectly due to the chilling consequences of regulatory breach by banks (see Chapter Five s.5.3).

¹⁹² Discussed in Chapter Two s.3.2.2 B.

scrutiny or whether they are being unfairly targeted. This is one of the themes identified in the data analysis as being of relevance to Muslim charities in the domestic jurisdiction, and the question of whether Muslim charities are unfairly targeted is explored further in the forthcoming chapters.

The research also explores the extent to which matters of regulatory compliance impact on relationships between charities and financial institutions, introduced in this chapter. The financial services sector has come under increased pressure as ‘follow the money’ and ‘freezing the money’ are central to policy goals, and the responsibility to protect the integrity of the financial system is incumbent upon them. In an effort to reduce their exposure to risk as a direct result of the CTF legal framework, banks may decide to sever their relationships with entities such as correspondent banks, MSBs and NPOs all of which can make the operating environment for NPOs difficult, and in some cases impossible without potentially contravening sanctions regimes and other CTF legal requirements. As a direct consequence of banks’ de-risking policies vulnerable communities may find themselves financially excluded, as vehicles for transferring funds and banking facilities are closed to them. These may be the same communities that NPOs may need to reach. Further discussion and analysis regarding regulatory compliance and the impact on relationships between charities and financial institutions is presented in Chapter Seven in which some of the practical implications for both financial institutions and NPOs of operating within this complex legal landscape will be discussed with reference to the domestic jurisdiction and to the empirical data.

It is vital therefore that the NPO sector has a powerful voice, and itself can exert influence on this influential body. For example, alerting policy makers of challenges experienced with the regulation and advising policy makers on how the negative impact of the regulation may be diminished.

CHAPTER 5: THE UK COUNTER-TERRORIST FINANCE (CTF) REGIME- IMPLEMENTATION OF THE REGULATORY REQUIREMENTS AND WHAT THIS MEANS FOR THE CHARITY SECTOR

1. INTRODUCTION

This chapter will consider the UK's strategic response to the threat of terrorist financing; the implementation of obligations imposed by the global standards of the Financial Action Task Force (FATF) and the UN sanctions regime, outlined in the previous chapter. The events of 9/11 served as a catalyst for change, and to heighten recognition that the threat posed by terrorist financing should be tackled on an international as well as domestic level. The centrality of the Terrorism Act 2000 (TACT), providing definitions of terrorism, terrorist property and substantive criminal terrorist-related offences, and the further development of the legislative framework in the post 9/11 era will be discussed. Targeting the financial assets of terrorists, for example, has been an important element of the strategic response; the asset freeze regime is considered here, as charities as well as the institutions providing their banking services may need to have regard to this.

The position of the domestic charity sector will be considered against this regulatory backdrop, providing further context for the empirical chapters; highlighting the requirements of due diligence, including matters relating to sanctions and asset freeze regimes (discussed further in Chapter Six); examining the role of the Charity Commission as the sector regulator (discussed in greater depth in Chapter Eight); and assessing the extent of the problem of terrorist financing within the sector. As previously highlighted in the introduction to this work, attention is focused on the charity sector under the jurisdiction of the Charity Commission for England and Wales, as the cohort of interviewees is

drawn from this geographical area. The regulatory requirements however apply equally to charities in Scotland and Northern Ireland.¹

Charities require the financial services of banks and possibly Money Service Businesses (MSBs). The burden of regulatory compliance for banks in particular may affect decisions made with respect to risk, and which customers present too great a risk. The impact of this has been consistently felt in correspondent banking, MSBs and within the charity sector.² The environment in which financial service providers operate therefore, may directly affect their decisions to ‘de-risk.’ This operating environment will be discussed with particular reference to the ‘follow the money’ doctrine, the reporting of suspicious activity and the impact of financial directions, illustrating some of the challenges of operating within this regulatory framework.

As charities are dependent on banking services, the decision to ‘de-risk’ and withdraw those services may considerably increase the operational cost and risk for the charity. Such issues are discussed later in the context of the empirical research, for example, where a charity had to use significant resources to provide information required by the bank to avoid threatened account closure, and another incident where a bank operated without a bank account.³ The relationship between these sectors has been particularly problematic for organisations operating in areas of political instability or where there is known terrorist activity.⁴

2. THE UK’S STRATEGIC RESPONSE TO TERRORIST FINANCING

Prior to the events of 9/11, the UK had a well-developed CTF regime in place, informed by the terrorist financing intelligence gained from campaigns against

¹ Under the jurisdiction of the Office of the Scottish Charity Regulator (OSCR) and the Charity Commission for Northern Ireland (CCNI) respectively.

² For example: Tracey Durner and Liat Shetret, ‘Understanding Bank De-risking and Its Effects on Financial Inclusion’ (Global Center on Cooperative security/Oxfam November 2015); Sue Eckert, Financial Access for US Nonprofits (Charity and Security Network February 2017).

³ See Chapter Seven 5.2.

⁴ David Artingstall and others, ‘Drivers and Impacts of Derisking: A study of Representative Views and Data in the UK’ (John Howell and Co. Ltd 2016) 11.

terrorist groups in Northern Ireland. In the post 9/11 era, although the threat posed by domestic terrorism still existed, it was recognised that the threat from ‘extremists using a distorted and unrepresented version of the Islamic faith to justify violence’,⁵ carried out by both British nationals and outsiders, represented a more immediate concern and a different set of challenges. Prime Minister Tony Blair immediately promised a review of, *inter alia*, extradition laws, the link between terrorism and crime and the sources of terrorist finance.⁶

Countering terrorist financing has been recognised as a vital element in the protection of the UK’s national security and integral to the strategy that developed post 9/11. The aim of the UK AML/CTF strategy according to the FATF, can be categorised under three headings: to deter, detect and disrupt. The deterrent comes from both adequate supervision and appropriate safeguards being in place. The detection element derives from financial intelligence, which facilitates the identification of criminals financing terrorism, and disruption is achieved by means of criminal prosecutions and freezing of terrorist assets.⁷ This is congruent with the ‘Pursue’ strand of the overarching UK counter-terrorism strategy.⁸

The National Risk Assessment for Money Laundering and Terrorist Financing (NRA) highlighted three main areas of focus; ‘reducing terrorist fundraising in the UK; reducing the movement of terrorist finance into and out of the UK; and reducing the fundraising and movement of terrorist finance overseas’.⁹ The second NRA in 2017 assessed both the progress of reforms previously initiated and the current terrorist financing risk, as a basis for future policy decisions.¹⁰

⁵ FATF, ‘Third Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism: The UK and Northern Ireland’ (FATF/OECD 2007).

⁶ Tony Blair, H.C Debs vol.372 col 606 14/9/2001 (quoted in David Bonner, Responding to Crisis: Legislating Against Terrorism (2006) 121 Law Quarterly Review 602, 615).

⁷ FATF, Third Mutual Evaluation Report (n 5).

⁸ HM Government, *CONTEST: The UK’s Strategy for Countering Terrorism* (Cmd 9608, June 2018) 29.

⁹ HM Treasury/Home Office, *UK National Risk Assessment of Money Laundering and Terrorist Financing* (October 2015) 89.

¹⁰ HM Treasury/Home Office, *National Risk Assessment of Money Laundering and Terrorist Financing* (October 2017).

The UK's AML/CTF strategy was, according to a Treasury report, founded on principles of 'effectiveness, proportionality and engagement'; aiming to engage with actors in both public and private sectors in the UK and abroad.¹¹ The asset freeze regime is now a central component of the UK strategy, with law enforcement agencies and others in the criminal justice sector shifting their focus from the prosecution of those involved in financing terrorism to the freezing of their assets.¹²

Prior to 9/11, it was suggested that the banking sector was ill-equipped to identify terrorist financing, lacking expertise in this area and having no law enforcement powers.¹³ Ridley, whilst accepting that law enforcement is outside the remit of regulators, maintains that their utility lies in their unique experience, enabling them to firstly identify, and then monitor suspicious activity, and to form collaborative partnerships with law enforcement agencies.¹⁴

The financial sector is now recognised as a valuable partner and key component of the government's strategic response to terrorist financing (together with other legitimate businesses, lawmakers and law enforcement agencies).¹⁵ The impact of this regime both on financial institutions and more indirectly on organisations such as NPOs will be discussed later in this chapter.

3. THE UK CTF LEGAL FRAMEWORK

3.1 Defining terrorism, terrorist property, terrorist financing offences and the concept of proscription- the impact of the Terrorism Act 2000

¹¹ HM Treasury, *The Financial Challenge to Crime and Terrorism* (February 2007) 9.

¹² Nicholas Ryder, *The Financial War on Terrorism: A Review of Counter-terrorist Financing Strategies since 2001* (Routledge 2015) 97.

¹³ Nicholas Ridley, 'Combating Terrorist Financing: The Dichotomy between Formulating the Legal Bases and Effective operational Intelligence' in *Legal Aspects of Combating Terrorism* CEDAT (ed) (IOS Press 2008) 58.

¹⁴ *ibid.*

¹⁵ HM Treasury, *The Financial Challenge to Crime and Terrorism* (n 11) 9-11.

The Terrorism Act 2000 (TACT) became the foundation of the CTF strategy in the UK, widening its focus beyond that of Northern Ireland as terrorist finance provisions extended to international terrorism, and to non-UK residents.¹⁶ One of the principal innovations was the introduction of a definition of terrorism; international in scope and having similarities with definitions emanating from other international organisations and developed states at the time.¹⁷ The definition provides that any ‘action’ may be directed against any government, there being no requirement, for the government to be democratically or legitimately established.¹⁸ Furthermore, as such ‘action’ could take place inside or outside the UK the definition would encompass cyber-terrorism as well as the more traditional terrorist crimes.¹⁹ The Independent Reviewer of Terrorism in his annual report of 2018 published a discussion document with respect to the definition in light of the attack on Sergei Skripal and daughter Yulia in Salisbury, and the question of ‘state terrorism’,²⁰ which illustrates the dynamic nature of the debate on definition.

The concept of terrorist property is also widely defined by the TACT 2000 s.14 (1). Terrorist property could therefore include donations from diaspora communities and the proceeds of crime carried out for the purpose of funding terrorist acts.²¹ The interpretation of terrorist property also makes clear that money paid with regard to committing an act of terrorism is included, as are any resources of a proscribed organisation, whether these be for direct terrorist purposes, for example purchasing weapons, or for non-violent purposes such as buying food/paying rent.²²

¹⁶ TACT 2000 s.1(4).

¹⁷ Ben Brandon, ‘Terrorism, Human Rights and the Rule of Law: 120 Years of the UK’s Legal Response to Terrorism’ [2004] December Criminal Law Review 981,984.

¹⁸ *ibid* 985.

¹⁹ R Bell, The Confiscation, Forfeiture and Disruption of Terrorist Finances (2003) 7(2) Journal of Money Laundering Control 105,109.

²⁰ Clive Walker, ‘Note on the Definition of Terrorism under the Terrorism Act 2000, s.1 in light of the Salisbury Incident’ in Max Hill, ‘The Terrorism Acts in 2017: Report of the Independent Reviewer of Terrorism’ (October 2018) Annex 3 129.

²¹ Bell (n 19) 109.

²² HM Government, *Explanatory notes to the Terrorism Act 2000*.

The substantive criminal offences created by the TACT 2000 include a number relating to terrorist financing, which are particularly relevant to this discussion. The offence of fundraising for terrorist purposes is committed under s15 if a person provides money or other property in the knowledge that it will be, or suspects that it will be or may be used for the purpose of terrorism or invites others to do so. An offence will also be committed if money or other property is received for such purposes.²³ Thus the offence is committed through personally raising funds for terrorist purposes or facilitating others to do so.²⁴ The second offence describes the use of funds or other property for terrorist purposes or the possession of the same intending that it be used, or having reasonable cause to suspect that terrorism may be the ultimate use.²⁵

The third offence concerns funding arrangements, which could involve entering into or becoming concerned with such an arrangement resulting in funds being made available, or made available to another person, knowing or having reasonable cause to suspect that it may be used for terrorism.²⁶ This was tested recently in the case of the parents of Jack Letts in that reasonable cause to suspect that money or property may be used for terrorism purposes should be assessed objectively, and therefore no proof of suspicion is required.²⁷

The fourth principal offence involves facilitating the laundering of money or property for terrorist purposes, which covers, for example, dealing with money or property by concealment, removal from the jurisdiction or transferring property to another party. Section 18 also makes clear that any other arrangement which 'facilitates the retention or control by or on behalf of another party of terrorist property' also constitutes an offence. Neither the intention to commit the offence, nor knowledge or reasonable suspicion that it may be committed is required in the application of this offence, in contrast to the offences under s.15 - s.17.²⁸

²³ TACT 2000 s.15.

²⁴ *Ryder* (n 12) 100.

²⁵ TACT 2000 s.16.

²⁶ TACT 2000 s.17.

²⁷ *R v Sally Lane and John Letts (AB&CD)* [2008] UKSC 36.

²⁸ *Ryder* (n 12) 101.

Rowe noted that the Act does not create any *offence* of terrorism. Terrorism as a concept, as defined in the Act, gives rise to the powers to prevent, detect and investigate as well as to intercept funds and property destined for terrorist purposes.²⁹ Whereas jurisdiction under previous Prevention of Terrorism Acts (PTA) was territorial,³⁰ the usual principle underlying criminal law, courts are empowered, under the TACT 2000, to try terrorist offences occurring outside the UK.³¹ 'If a person does anything outside the United Kingdom, and his action would have constituted the commission of an offence under any of s.15-18 if it had been done in the United Kingdom, he shall be guilty of an offence.'³² With this widened jurisdiction, with potential for near universal application, the UK was also fulfilling obligations under a number of international anti-terrorism treaties.³³

The TACT 2000 maintained the concept of proscription; familiar to previous PTAs, with new powers to proscribe any organisation deemed to be associated with terrorism.³⁴ At its inception the list included only terrorist groups of Irish origin.³⁵ Although fourteen listings currently relate to Northern Ireland, the majority of the 76 listed international terrorist organisations are 'Islamist' militant groups.³⁶ Subsequent legislation relating to support for proscribed organisations conferred extra-territorial jurisdiction for these offences for UK residents and British nationals.³⁷ A further unique aspect of the Act was the provision for de-proscription,³⁸ and the creation of the Proscribed

²⁹ J Rowe, 'The Terrorism Act 2000' (2001) July Criminal Law Review 527,510

³⁰ For example, The Northern Ireland (Prevention of Terrorism) Act 1974 and The Prevention of Terrorism (Temporary Provisions) Act 1989 Part III.

³¹ Brandon (n 17) 984.

³² TACT 2000, s.63.

³³ Brandon (n 17) 984.

³⁴ TACT 2000, s.3.

³⁵ Terrorism Act 2000, sch 2.

³⁶ Home Office, *Proscribed Terrorist Organisations* (12 April 2019).

³⁷ Counter-Terrorism and Border Security Act 2019.

³⁸ TACT 2000, s.4.

Organisations Appeal Commission (POAC).³⁹ This process was used by the Peoples Mujaheddin of Iran (PMOI) to challenge its proscribed status in 2002.⁴⁰

3.2 Further legislative measures

The legislative response to the 9/11 attacks was a range controversial measures, passed in haste.⁴¹ The Anti-Terrorism, Crime and Security Act 2001 (ATCSA) received a mere 16 hours of scrutiny by the Commons, however the House of Lords imposed a number of defeats and was highly critical of the apparent lack of concern for the human rights of UK citizens.⁴²

The Act contained measures which effectively authorised law enforcement agencies to seize terrorist cash anywhere in the UK,⁴³ to monitor accounts under suspicion,⁴⁴ to freeze suspected terrorist funds at the start of an investigation and allow the freezing of accounts of persons where there is reasonable grounds for suspicion that they pose a threat to the UK⁴⁵ and to impose reporting obligations on financial institutions suspecting funds are being used for terrorist purposes.⁴⁶ The diverse powers permitted by the Act also proved controversial, some having little or no connection to terrorism, contrary to the spirit of the Act namely, to remain within the boundaries of necessity in order to meet the terrorist threat.⁴⁷

An independent review of the legislation recognised the continuing need for separate CT legislation, distinct from ordinary criminal law, limited to terrorist matters and subject to appropriate safeguards, reflecting policies agreed by the

³⁹ TACT 2000, s.5.

⁴⁰ The organisation was removed from the proscribed terrorist list in 2008 as a result of a POAC and Court of Appeal judgment. Home Office, *Proscribed Terrorist Organisations* (22 December 2017) 4.

⁴¹ Bonner (n 5).

⁴² Helen Fenwick, 'The Anti-Terrorism Crime and Security Act 2001: A Proportionate Response to 11 September?' (2002) 65(5) *Modern Law Review* 724, 729.

⁴³ Anti-Terrorism Crime and Security Act 2001 (ATCSA), sch 1, part 2 (para2).

⁴⁴ ATCSA sch 2 part 1.

⁴⁵ ATCSA part 2 s.4.

⁴⁶ ATCSA sch 2 part 3.

⁴⁷ Fenwick (n 42) 761.

international community.⁴⁸ The legislation was the precursor to a more specific, defined CTF strategy, which is continually evolving.⁴⁹

3.3 Targeting financial assets of terrorists-the asset freeze regime

Obligations imposed by UNSCR 1373 on all states to freeze the assets of individuals and organisations committing or suspected of committing acts of terrorism, were supported by recommendations of the FATF and EU Regulation as outlined in Chapter Four. The EU, although not a member of the UN, has effectively implemented the obligations imposed by UNSCRs to ensure that its legislation is congruent with these international legal obligations.⁵⁰ This process of subsuming UNSCRs into the EU legal order, which Lavranos describes as 'Communitarisation',⁵¹ could equally describe the process by which the FATF recommendations are transposed into national laws.

In the domestic arena, The ATCSA 2001 clearly had limitations, with no application to UK-based persons or extending to harm directed toward interests outside the UK. The Treasury was not required to prove the element of detriment to the UK economy (a threat alone being sufficient) neither was there a requirement for criminal activity, or any suspicion that such activity has taken place.⁵² Any actual terrorist link was not required in order for a freezing order to be made, as the two requisite conditions (s.4) were widely drafted. This led to the bizarre application of powers available under the anti-terrorist legislation to enable the assets of the Icelandic bank, Landsbanki, to be frozen.⁵³

⁴⁸ Privy Counsellor Review Committee, *'Anti-terrorism, Crime and Security Act 2001 Review: Report'* (2003) 4, 8.

⁴⁹ For example, Police and Crime Act 2017 now allows the implementation of UN listings immediately in the UK, as the delay in implementation at EU level caused concerns of possible asset flight.

⁵⁰ Christian Kaunert and Marina Della Giovanna, 'Post 9/11 EU Counter-terrorist financing cooperation: Differentiating supranational policy entrepreneurship by the Commission and council Secretariat' (2010) 19 (2) *European Security* 275, 277.

⁵¹ Nikolaos Lavranos, 'UN Sanctions and Judicial Review' (2007) 76(1) *Nordic Journal of International Law* 1, 3-4.

⁵² Karen Harrison and Nicholas Ryder, *The Law Relating to financial Crime in the UK* (Ashgate 2013) 56.

⁵³ The Landsbanki Freezing Order 2008, SI2008/2668.

A further element of the asset freeze regime comprises the provisions of the Al-Qaida and Taliban (asset-freezing) Regulations,⁵⁴ relating to the obligations imposed by UNSCR 1267(1999). The regulations allow the imposition of criminal penalties for breach of the EU Regulation implementing the UN sanctions.⁵⁵ A designation under this instrument has the advantage of having global effect, but the process is necessarily limited to the terrorists named in its title.

The Terrorist Asset Freezing Act 2010 (TAFa) empowers the Treasury to freeze assets of those individuals or groups believed to be involved in terrorism and deprive them of access to finances,⁵⁶ giving effect to UNSCR 1373 (2001) as previous Orders purported to do.⁵⁷ Persons included on the EU list may also be subject to the provisions of the TAFa, as such the UK fulfils its obligations to give effect to the EU's own implementing measures.⁵⁸ UK designations may also form the basis of a EU designation, as was the case of five Iranian nationals designated in the UK in October 2011, having been days earlier designated in the USA and implicated in an alleged state-sponsored terrorist plot.⁵⁹ The provisions of the Sanctions and Money Laundering Act 2018 (SAMLA) were designed to enable sanctions to continue in the domestic jurisdiction uninterrupted post-Brexit.⁶⁰

In reality the designation process under the TAFa 2010 can be rapid, with the advantage of potential use on both domestic and overseas targets, however it is only effective in the UK and on UK nationals and bodies overseas.⁶¹ Anderson, however noted in his first review of the legislation that compatibility with the

⁵⁴ The Al-Qaeda (asset-freezing) Regulations 2011, SI 2011/2742.

⁵⁵ Council Regulation EC 881/2002 imposing certain specific restrictions against persons and entities associated with Usama Bin Laden, the Al-Qaeda network and the Taliban.

⁵⁶ TAFa (2010) part 1.

⁵⁷ For example, The Terrorism (United Nations Measures) Order 2001 SI2001/3365 and the Terrorism (United Nations Measures) Order 2009 SI2009/1747.

⁵⁸ Council Regulation 2001, 2580/2001 s.1 (b).

⁵⁹ David Anderson, 'Second Report on the Operation of the Terrorist Asset- Freezing etc. Act 2010' (December 2012)10.

⁶⁰ HM Treasury/Office for Financial Sanctions Implementation, *Post Brexit: Financial Sanctions – General Guidance* (1 February 2019).

⁶¹ TAFa 2010, s.13.

ECHR, which was formerly in question, was more secure.⁶² The asset freeze regime has on occasion been used to good effect for example, police arrested individuals suspected of plotting terrorist attacks on airplanes leaving the UK and the Treasury had frozen the assets of 19 suspected terrorists before the banks had opened the following day.⁶³

However, the regime has been criticised for being under-utilised; only one person had been designated in the 2013 reporting period, and that designation had not been considered in the case of 24 convicted terrorists.⁶⁴ The number of designations had risen to 8 by the following year, apparent evidence of the response to the threat of UK residents travelling to Syria and Iraq for terrorist purposes.⁶⁵ Anderson maintains that designation under the TAFA 2010 could be used to greater effect, given the numbers of those travelling (estimated at 600) and the potential for disrupting those individuals who cannot be prosecuted, but for whom the restriction of their financial access could provide wider public protection against terrorism.⁶⁶ Of the 14 designations recorded in June 2017 under the TAFA 2010 all were suspected to be living overseas and the total of £9,000 funds frozen at that time remarkably low.⁶⁷ The published figure representing the total funds frozen remains static.⁶⁸

4. THE POSITION OF DOMESTIC CHARITIES WITHIN THE REGULATORY FRAMEWORK

4.1 The policy basis for intervention in charities-the role of the regulator

The Charity Commission for England and Wales, established under legislation in 1853, now assumes the responsibility of both registrar and regulator of

⁶² David Anderson, 'First Report on the Operation of the Terrorist Freezing etc. Act 2010' (December 2011) 27.

⁶³ House of Commons, *Written Ministerial Statement: Ed Balls* (Cm 2005, 2006)

⁶⁴ David Anderson, 'Third Report on the Terrorist Asset-Freezing etc. Act 2010' (December 2013) 9.

⁶⁵ David Anderson, 'Fourth Report on the Terrorist Asset-Freezing etc. Act 2010' (March 2015) 19.

⁶⁶ *ibid.*

⁶⁷ HM Government, 'Written Ministerial Statement: Stephen Barclay: Operation of the UK's Counter-terrorist Asset Freezing Regime Report to Parliament: 1.4.2017-30.6.2017' (2017)

⁶⁸ HM Government, 'Written Ministerial Statement: Operation of the UK's Counter-terrorist Asset Freezing Regime Report to Parliament: 1 April 2019-30 June 2019'.

charities, as well as fulfilling an advisory role. Changes in the legal framework affecting the charity sector were introduced by the Charities Act 2006 and they were further consolidated in the Charities Act 2011. For example, an entity must demonstrate that it fulfils a 'charitable purpose' by satisfying one or more of the thirteen specific purpose categories set out in the Charities Act 2011.⁶⁹

As at March 2019 there were over 168,000 charities registered; similar to the previous year and nearly 1000 more than reported in 2017, with regulated income in one year amounting to £79 billion.⁷⁰ In addition there are perhaps an even greater number of unregistered charities, estimated by the National Audit Office to number over 191,000.⁷¹

Charities having an annual income above the threshold of £5,000 have an obligation to register with the Charity Commission, although there are some exemptions⁷² (usually large organisations: including most English universities and some museums). These exempt charities have another principal regulator and are therefore not directly regulated by the Commission.⁷³ A further category, of 'excepted' charities with the benefits and restrictions conferred by charitable status are not required to register, or to provide annual returns, provided their annual income falls below the £100,000 per year threshold.⁷⁴ Such 'excepted' charities include, for example, some Christian places of worship and Scout and Guide groups.

The Charity Commission may intervene in these non-registered entities and use its powers as it would in the case of regulated charities. Furthermore, it has a duty to protect any assets it considers charitable, whatever the source. Helping Humanity, a company raising funds ostensibly for the provision of aid to Syria, referred to 'charitable funds' in its appeals, thus making representation of a

⁶⁹ Charities Act 2011, s.3(1).

⁷⁰ Charity Commission, *Annual Report and Accounts 2017-2018* HC1211 4-6: Charity Commission, *Annual Report 2018-2019* HC 2318 12.

⁷¹ National Audit Office, 'Regulating Charities: A Landscape Review' (July 2012) 9.

⁷² Charities Act 2011, ss.22-28 and included in sch 3.

⁷³ Charity Commission, 'Guidance: Exempt Charities (CC23)' August 2019.

⁷⁴ Charities Act 2011 s.30.

charitable purpose. Raising funds from the public in this context was sufficient to warrant the Commission exerting its jurisdiction and moving to protect assets of the organisation on discovering aid convoys were used as a cover to support terrorism.⁷⁵ In this case the Commission worked with the Metropolitan Police Service (MPS) using its legal authority derived from the Charities Act 2011, to request from and to provide information to other agencies including the provision of witness statements to support a criminal investigation.⁷⁶

The Charity Commission though has been criticised in the past, and its ability to address terrorist financing called into question.⁷⁷ Further criticisms have been made concerning its reaction to incidents involving Islamic charities,⁷⁸ and a perception of bias against Muslim charities by the Commission was also the conclusion of a report by the think tank Claystone.⁷⁹

The Charity Commission is established as a non-ministerial government department and as such exercises its powers and responsibilities without being subject to the control of any individual minister or government department, thus operating independently, but having access to government and being accountable to Parliament.⁸⁰ Issues concerning the question of neutrality will be explored further in Chapter Eight in the discussion of the engagement of charities with the regulator.

4.2 The regulatory framework—what does it take to comply? The requirements of due diligence

The essential components of regulation require; that the rules and expected standards are made explicit; that there is a compliance monitoring system; and

⁷⁵ Charity Commission, 'Risks to Charities from an Individual Associated with Terrorism-Mashoud Miah' Decision 16 October 2017.

⁷⁶ *ibid.*

⁷⁷ The Henry Jackson Society, 'Counter-terrorism The Henry Jackson Society, Written Evidence submitted to the Home Affairs Committee 'Counter-terrorism' 9/5/2014 Reference CTE0015 para 23.

⁷⁸ Populus, 'Trust and Confidence in the Charity Commission' (July 2017) 22.

⁷⁹ Adam Belaon, 'Muslim Charities: A Suspect Sector' (Claystone November 2014).

⁸⁰ Richard Fries, 'The Charity Commission for England and Wales' in Klaus Hopt and Thomas Von Hippel (eds) *Comparative Corporate Governance of Non-profit Organizations* (CUP 2010) 900-901.

adequate enforcement mechanisms are in place.⁸¹ As a basis for the discussion arising from the empirical data analysis relating to engagement with the regulation, the requirements of the regulation with respect to the charity sector will be outlined in this section. With the increased scrutiny by the Charity Commission it is even more important that individual charities have sufficiently rigorous control mechanisms in place to reduce the risk of terrorist abuse, but also to demonstrate they are protecting their charity's assets.

Charity trustees have ultimate responsibility, under charity law, for the control and administration of the charity. Their principal duties are to advance the purpose of the charity, for the public benefit, and to act in its best interests, in so doing to: ensure that the charity's assets are used for the appropriate purpose, that they are adequately protected and to act reasonably and with prudence in all aspects of the administration of the charity's affairs, which includes its proper administration.⁸² The courts have also developed guiding principles for reviewing significant trustee decisions, for example, the requirement to be sufficiently informed, and to demonstrate that the principles have been observed.⁸³

Trustees acting in breach of their duties may find themselves liable for any loss that the charity suffers as a consequence; they are therefore obliged not only to adhere to the legal requirements placed upon them (both personally and in their official capacity as trustee), but also to follow the guidance for good practice that the Charity Commission publishes periodically.⁸⁴ To minimise the risk of abuse of a charity for terrorist financing purposes a robust framework should be instituted to assess and manage such risks, and to ensure strong

⁸¹ Christopher Hood and others, *Regulation inside Government: Waste-watchers, Quality police and Sleaze-busters* (OUP 1999).

⁸² Duties may vary slightly depending on the legal constitution; the Charities Act 2011 imposes duties on trustees of charitable incorporated organisations (CIO) and the Companies Act 2006 on those of charitable companies. Charity Commission, 'Compliance Toolkit: Protecting Charities from Harm' (April 2011 Revised October 2017) Chapter 1 Module 8.

⁸³ Charity Commission, 'It's Your Decision: Charity Trustees and Decision-making' (CC27, 2013, updated January 2017) 2.

⁸⁴ Charity Commission, 'The Essential Trustee: What you Need to Know, What you Need to Do' (July 2016).

financial management. Part of this internal control mechanism involves translating risk into the appropriate level of due diligence.

Thus, charity trustees, under a legal duty to protect charitable assets, are required to apply due diligence measures to donors, partners and beneficiaries. These “know your” principles, established under existing charity law, are also in compliance with FATF Recommendation 8, which requires that NPOs take ‘reasonable measures’ not only to identify, but also confirm the good standing of beneficiaries and partner NPOs, and to document the identity of major donors.⁸⁵

Charities, however, are not required to undertake the customer due diligence required of banks and other members of the regulated sector, as advocated by Recommendation 10. Nevertheless, the purpose of due diligence required of domestic charities which had, prior to 9/11, been accepted as integral to good governance, was expanded and augmented in importance in the post 9/11 era. The legal responsibilities of trustees apply regardless of the size or purpose of the charity. However, the risk-based approach as advocated by the FATF Recommendation 1 also forms a basic principle on which Recommendation 8 is founded. This recognises the diversity of threats faced by NPOs and the need for individual NPOs to allocate their resources and apply focused measures in accordance with the identified threats of terrorist financing within their organisation.⁸⁶

4.2.1 *The “know your” principles, relating to donors, partners and beneficiaries*

A) *Donors*

The first stage in the due diligence process is the identification of funding sources. Trustees are required to ascertain the provenance of charitable donations; particularly in the case of substantial donations, and should take reasonable steps to both identify and verify the identity of donors to satisfy

⁸⁵ FATF, ‘Interpretive Note to Recommendation 8’ (FATF/OECD 2016) 57-58.

⁸⁶ *ibid* 54.

themselves that the funds do not derive from an illegal or inappropriate source.⁸⁷ Charities, however, often receive funds by way of small cash donations; identifying the source of such donations would clearly be impractical, if not impossible, and indeed trustees are not expected to do so.

When considering the provenance of donations, trustees should also be vigilant about sources that may cause reputational harm or compromise the independence of the organisation. Due diligence in this respect may involve making further enquiries and checks on the business of donor organisations and ensure this is in accordance with the charitable purpose of the NPO. This would also apply to conditions attached to a donation that may give rise to concern. For example, a condition may result in the transfer of funds via the NPO to a third party, effectively without the trustees having the opportunity to verify the appropriateness of the end use of the funds.⁸⁸

It is permissible for charities to accept anonymous donations, but the risks of so doing should be assessed, and appropriate safeguards instituted, particularly for large donations or repeated smaller donations from the same source. Charities cannot generally refuse a gift or legacy except under exceptional circumstances.⁸⁹ Such circumstance may arise, for example, if there is suspicion as to the legality of source of funds or that accepting the donation would not, on balance, serve the best interests of the charity, as a matter of legal principle.

The Charities Statement of Recommended Practice (SORP) Committee, consulting on the revision of the recommended practice document (which serves as financial guidance in relation to charity accounting practice), made controversial proposals to require charities to identify donors by name, and publicise the amount given. The umbrella body the Charity Finance Group, amongst others, in contributing to this consultation considered this would be

⁸⁷ Charity Commission, *Compliance Toolkit* (n 82) ch 2.

⁸⁸ *ibid.*

⁸⁹ Will Henderson, *Tudor on charities* (10th Edition, Sweet and Maxwell 2015) 798.

detrimental to charities, particularly those relying on individual donations;⁹⁰ consequently the proposals were not pursued further.⁹¹

Trustees may be committing a criminal offence if they have financial dealings with a designated person or entity, or with proscribed organisations. It is therefore important that, as part of due diligence practice, they consider checking names of donors, beneficiaries and partners against the UK consolidated list of designated individuals and entities, published by HM Treasury.⁹² The list gives details of individuals and entities designated under the UK domestic asset freeze regime, the EU's Council Common Position 931 pertaining to the external terrorism regime (CP931) and UN Al-Qaeda sanctions regime. Other financial sanctions regimes may also apply and are included in the list, for example the sanctions pertaining to the Ukraine and Iran.

The Home Office list of Proscribed Terrorist Organisations should be checked as part of the due diligence process. It is an offence under s12 (2) (c) of the Terrorism Act 2000 to make arrangements for, or to manage a meeting (or assist in such arrangements or management) knowing that it will be addressed by a member (or someone who professes to be) of a proscribed organisation. There is however a statutory defence which may be helpful to persons carrying out humanitarian work in areas where proscribed groups are likely to operate, which relate to private meetings. Under s12(4) of the Act; having reasonable cause to believe that terrorist activities would not be advanced in the course of such a meeting, nor would the person addressing the meeting advance the proscribed organisation, would constitute a defence. The explanatory notes clarify the purpose of the defence, which is to allow 'genuinely benign' meetings; to facilitate delivery of humanitarian aid to a civilian population, for example.⁹³

⁹⁰ Charity Finance Group, 'Research Exercise on Charities SORP (FRS 102) consultation response' (December 2016).

⁹¹ Gareth Jones, 'Charities will not Have to Name Donors, says SORP Committee' (Civil Society 22 August 2017) <https://www.civilsociety.co.uk/news/charities-will-not-have-to-name-donors-says-sorp-committee.html> accessed 1 March 2020.

⁹² HM Treasury/OFSI, 'Consolidated List of Financial Sanctions Targets in the UK' Updated 22 September 2019.

⁹³ TACT 2000, Explanatory Notes 3.

Lists maintained by other countries should also be consulted if appropriate. If a beneficiary appears on such a list, consideration should be given to the impact this may have on the charity. Such lists have no legal effect in the UK; however, trustees should assess the risks that dealing with designated persons or individuals would present to the charity, especially if they are operating in that jurisdiction. The Charity Commission advises that risks to be assessed under such circumstances include; legal action against the charity, the safety of employees/trustees, possible legal action against a visiting trustee, reputational damage and risks of financial institutions refusing to provide services to the charity.⁹⁴

Trustees are also advised to consult the Home Office list as part of due diligence in the recruitment process, to ensure any new employees are not proscribed persons or belonging to a proscribed group (as well as consulting the Companies House register for disqualified directors, and list of removed trustees compiled by the Charity Commission, as appropriate.)

The Charity Commission has investigated financial practices falling short of their guidelines, for example, the case of Khawaja Disabled and Rehabilitation Centre, which forwarded a £15,000 donation to a project in Pakistan with no recorded audit trail. The charity Aid for Destitute Victims of Oppression was similarly investigated, and its trustees found to have acted as cash couriers for large sums destined for overseas projects. These cases illustrate poor practice rather than illegal activity and the Charity Commission, in its advisory role, assisted the latter charity in establishing more appropriate methods of funds transfer.⁹⁵

B) *Partners*

Trustees are obliged to apply due diligence measures to any partners they may associate with in order to carry out their work. Partners may be used, for

⁹⁴ Charity Commission, Compliance Toolkit (n 82) ch 1.

⁹⁵ 'Overseas Projects Investigated for Financial Practices' (*Third Sector*, 15 January 2003) <http://www.thirdsector.co.uk/overseas-projects-investigated-financial-practices/article/619019> accessed 1 March 2020.

example, when establishing a presence in a new area or to carry out specific activities. Collaboration with another charity may also be advantageous for logistical reasons. Due diligence would involve the trustees examining the integrity of the partner and satisfying themselves that such a partner was capable of, and indeed was, delivering the charitable aims of the charity.⁹⁶

C) *Beneficiaries*

Trustees have a duty to ensure funds are used for the benefit of its beneficiaries in accordance with the stated charitable purpose. They are therefore required to carry out due diligence measures to ensure that they know who such beneficiaries are, potentially applying the same approach and principles as regarding donors. Trustees should be alert to the possibility of false grant applications and, once received, monies falling into the hands of terrorists. Examples of incidents involving terrorism-related training have been cited by the Charity Commission where charities hired out outdoor training facilities which have, unbeknown to them, been used by terrorists.⁹⁷ This underlines the importance of knowing who their customers/beneficiaries are, and being able to demonstrate the process by which they satisfy themselves that the funds are reaching the intended recipient, and appropriate safeguards are in place. Trustees are not expected to determine whether a criminal act has taken place; they are however, expected to take the appropriate measures to report concerns.

4.2.2 *Monitoring responsibilities*

Trustees are under a legal obligation to account for the proper use of funds; therefore, monitoring is essential to ensure funds are used only for the designated charitable purpose. A system of proper record keeping is essential to demonstrate fulfilment of their obligations in this regard. Effective monitoring

⁹⁶ Charity Commission, Compliance Toolkit (n 82) 34.

⁹⁷ Nick Donaldson, 'Who can Charities Work with Internationally?' (Charity Commission 6 September 2016) <https://charitycommission.blog.gov.uk/2016/09/06/due-diligence-and-monitoring-when-getting-down-to-specifics-the-lists-arent-endless/> accessed 1 March 2020.

may also identify incidents where funds have gone astray, thus enabling trustees to take appropriate action. Furthermore, the existence of robust monitoring systems may act as a deterrent to would-be abusers of the funds. The Charity Commission advises that monitoring systems meet the specific requirements of the charity, proportionate to the risk involved.⁹⁸ However robust the requirements may be though, the research suggests that implementation of such requirements is inconsistent at best, which is one of the themes identified in the empirical work and considered in Chapter Six.

For NPOs operating overseas and working with partners to deliver their charitable purpose, the requirements for monitoring may necessarily be more stringent. Factors influencing the degree of additional monitoring required may depend on; the existence of an internal audit facility with the capability to extend to overseas project monitoring; the capability of the partner organisation to deliver, monitor and report on the end use of funds, whether the evidence provided by audit trails in itself is sufficient to satisfy the requirement for proper use of funds and whether the formal banking system is utilised for the delivery of funds locally. The guidance from the Charity Commission does not include specific advice on individual partner agencies, or advice on monitoring project delivery in specific jurisdictions, as this may be construed as involvement in the administration of a charity, prohibited under charity law.⁹⁹

An accountant, or appropriate independent technical expert may be commissioned to monitor a project, to verify the audit trail from charity to partner and from partner to end user and, importantly to satisfy themselves that the funds were actually used for the purpose intended (as the audit trail may not necessarily demonstrate this.)¹⁰⁰

4.2.3 Reporting responsibilities

Having outlined and considered the due diligence and monitoring requirements of charities it is also central to this discussion to consider the obligation placed

⁹⁸ Charity Commission, Compliance Toolkit (n 82) ch 2 38.

⁹⁹ Charities Act 2011, para 20(3).

¹⁰⁰ Charity Commission, Compliance Toolkit (n 82) ch 2 39-41.

upon their trustees to report suspicious activity relating to the financing of terrorism.

Under s.19 of the Terrorism Act 2000 (as amended by the Counter-Terrorism Act 2008) there is a positive legal duty, which applies to 'office holders', to make a disclosure to a 'constable' (or an officer of the National Crime Agency NCA) of any suspicion or belief that an offence has been committed under s15-18 of the above-mentioned act (the terrorist financing offences.) The range of persons to whom the duty applies was widened in the 2008 Act to encompass a suspicion or belief held 'in the course of employment' (whether associated with a trade, profession, business or none of these.) This resulted in charities being included, within the meaning of 'office holder' extending to volunteers, interns and anyone on a formal work experience programme as well as applying to trustees.¹⁰¹

The Charity Commission issued an alert to charities with respect to the statutory reporting requirement, having identified low levels of awareness and, as a consequence, trustees were risking criminal prosecution, with a maximum penalty of 5 years imprisonment, a fine or both. The Commission reported investigations carried out by SO15 - National Terrorist Financial Investigations Unit (NTFIU) into a number of charities whose assets had been diverted to proscribed terrorist groups.¹⁰² In the reported cases no evidence was found indicating collusion with terrorist groups, but there had been a failure in one instance to make the necessary report in accordance with s.19 TACT 2000 when suspicion had been raised. However, the Crown Prosecution Service (CPS) concurring with the views of the SO15-NTFIU decided it was not in the public interest to prosecute.¹⁰³

Charities are thus required to comply with a whole range of due diligence and reporting measures. Failure to comply may, in some cases, have serious

¹⁰¹ TACT 2000, s.19(b).

¹⁰² Charity Commission, 'Terrorism Act Alert' (Regulatory advice given under s.15(2) Charities Act 2011, 30 September 2015) 9.

¹⁰³ *ibid.*

consequences as outlined above. The organisation British Overseas NGOs for Development (BOND) called for a defence for trustees and staff acting in good faith, on the basis that the fear of unwittingly committing a criminal offence may act as a deterrent to humanitarian work in areas where it is most needed. The proposed defence would cover scenarios where there may have been incidental contact with proscribed organisations, deemed necessary for the purpose of delivering humanitarian assistance in the absence of any reasonable alternative.¹⁰⁴ The proposal was not, however, given consideration by the government.

In a recent Home Office (HO) publication, it was considered that the introduction of a 'humanitarian exemption' would leave NPOs vulnerable to exploitation and for this reason no legislative concessions would be made.¹⁰⁵ However, this is countered by the requirement that the CPS consider individual cases of alleged contravention of terrorist legislation on their merits; whether the seriousness, the culpability of the alleged offender and public interest considerations would merit prosecution. The risk of an individual being prosecuted in the UK for a terrorist offence in the course of carrying out humanitarian work is low; The HO reported being 'unaware of any recent prosecutions of NGOs or their staff for terrorism offences.'¹⁰⁶

HM Treasury have issued some very specific general licenses which allow activity prohibited by financial sanctions, for example, to allow the provision of legal aid by a solicitor.¹⁰⁷ There has been discussion about issuing general licenses with respect to the provision of humanitarian aid to areas affected by sanctions, however the details and proposed criteria upon which this regime will be based has not yet been revealed by the Government.¹⁰⁸

¹⁰⁴ BOND, 'Review of Safeguards to Protect Charity Sector from Terrorist Abuse.' (written report to Home Affairs Committee August 2007).

¹⁰⁵ The Home Office, 'For Information Note: Operating Within Counter-terrorism Legislation' (Updated 12 April 2019).

¹⁰⁶ *ibid.*

¹⁰⁷ HM Treasury, 'Terrorism and Al-Qaeda Financial Sanctions General Licence (Legal Aid)' (AFU/2011/G4).

¹⁰⁸ Max Hill, 'The Terrorism Acts in 2016: Report of the Independent Reviewer of Terrorism Legislation on the Operation of the Terrorism Acts 2000 and 2006' (January 2018).

There have been very few cases of charitable organisations operating in the UK who have been subject to financial sanctions.¹⁰⁹ The Sanabel Relief Agency, a charity operating in several major UK cities, was placed on the UN sanctions list pursuant to UNSCR 1267 and the US designated the charity as a terrorist organisation.¹¹⁰ The Charity Commission also took steps to freeze the assets of the charity as the directors had used the charity as a vehicle to transfer funds overseas for terrorist purposes and was effectively a front organisation for the Al-Qaeda affiliated Libyan Islamic Fighting Group.¹¹¹

Financial services providers are required to freeze the assets of designated persons and suspend any services supplied to them. The Charity Commission too has authority to freeze assets believed to be charitable in nature, in order to protect them, for example freezing the building society account of an individual who has raised funds purportedly for a charitable cause, but those funds were intended for terrorist purposes.¹¹²

These targeted asset freeze regimes represent one element of the overall suite of financial sanctions available, but represent the regimes that charities are most likely to come into contact with. Some of the unintended consequences of UN sanctions regimes have been to restrict humanitarian aid to countries where sanctions are in place or to areas where non-state armed groups, such as IS or the Taliban, operate.¹¹³ As charitable organisations may be exposed to persons subject to such financial sanctions, awareness of designations and having access to the various listings may be of great importance. Failure to comply with

¹⁰⁹ Clive Walker, 'Terrorist Financing and the Governance of Charities' in Colin King, Clive Walker and Jimmy Gurulé *The Palgrave Handbook of Criminal and Terrorism Financing Law* (Palgrave 2018) 1095.

¹¹⁰ US Department of the Treasury, 'Treasury Designates UK-based Individuals, Entities Financing Al Qaida-affiliated LIFA' (Press release 2 August 2006)

¹¹¹ Daniel Lombard, 'Charity with Al-Qaida link remained on charity register for 6 years after UN sanctions began' (Third Sector 14 February 2013).

¹¹² Charity Commission, 'Funds raised for charitable purposes and held on charitable trust in the name of Adeel Ul-Haq' (Inquiry report, 26 July 2016).

¹¹³ International Peace Institute, 'Safeguarding Humanitarian Action in Sanctions Regimes' (Issue Brief, June 2019).

financial sanctions legislation constitutes a criminal offence.¹¹⁴ The question of whether the fear of contravening sanctions legislation affects the approach charities take to the delivery of aid is explored in the forthcoming empirical chapters, as well as other issues relating to compliance which may impact on the ability of charities to pursue their charitable objectives.

4.3 Is there a problem in the domestic jurisdiction?

As in the wider context, it is extremely difficult to ascertain the size of the problem of misuse of UK charities for terrorist financing purposes. According to the Charity Commission's risk strategy document, the abuse of charities for terrorist-related purposes is one of the three strategic risks it faces; the others relate to other financial crimes and to safeguarding concerns.¹¹⁵

Metcalf-Hough et al noted that there is a 'genuine risk that British International NGOs may be abused for extremist or terrorist purposes, but that the risk has been overstated by some interested parties.'¹¹⁶ The recent National Risk Assessment for Money Laundering and Terrorist Financing (NRA) suggests that the terrorist financing risk lies predominantly within the section of charities operating overseas, particularly Syria and Iraq, and identifies the small charities within this group (with an annual income of less than £10,000) as having particular vulnerabilities.¹¹⁷ The risk of abuse for terrorist financing purposes to the sector as a whole however, is now assessed as low.¹¹⁸

The NRA did not identify 'sham charities' as being a problem in the UK, however abuse of charities by those working within the organisation was considered to be a potential terrorist financing risk, as was the misappropriation of funds in the destination country i.e. the diversion of funds. Potential vulnerabilities were

¹¹⁴ HM Treasury /Office of Financial Sanctions Implementation 'Financial Sanctions Guidance' (March 2018).

¹¹⁵ Charity Commission, 'Counter-terrorism Strategy' (Policy Paper, 2015) 1.

¹¹⁶ Victoria Metcalfe-Hough, Tom Keatinge and Sara Pantuliano, 'UK Humanitarian Aid in the Age of Counter-terrorism: Perceptions and Reality' (Working paper, Humanitarian Policy Group 2015) 23.

¹¹⁷ HMT/HO, NRA 2017 (n 10) 73.

¹¹⁸ *ibid.*

also identified with aid convoys,¹¹⁹ and with technology as an emerging risk; with the use of social media to solicit donations, and online fundraising platforms becoming commonplace, these have been used by terrorists purporting to be raising funds for charitable purposes.¹²⁰

Furthermore, a recent HO review investigating the nature of support given to UK-based Islamist extremists, concluded that small anonymous donations were the major source of their funding, originating from individuals based in the UK. The review also found that some of the entities of concern were Islamic organisations purporting to be charities.¹²¹

The 2015 Government review of the Muslim Brotherhood, which in the UK comprises various loosely associated organisations, found that a network of charities had developed with links to the Muslim Brotherhood (although none had openly admitted to this). Links had similarly been found to Hamas, the self-proclaimed Palestinian branch of the Muslim brotherhood, proscribed as a terrorist organisation in the UK (military wing) apparently operating in the UK for over a decade.¹²²

The charity World Vision was reportedly infiltrated by a Hamas operative who ultimately became a director of the charity in Gaza and orchestrated the diversion of approximately £5.3 million per year to Hamas; the majority of the funds allegedly used to pay salaries and provide operational support for terrorist activities, according to the Israeli intelligence services.¹²³

There have been incidences of convictions for terrorist financing offences: In early 2016 the Charity Commission reported on the conviction of Adeel Ul-Haq

¹¹⁹ *ibid* 74.

¹²⁰ *ibid*.

¹²¹ Amber Rudd, *Extremism-Written Statement* (HC WS39 12.7.2017).

¹²² House of Commons, *Muslim Brotherhood Review: Main Findings* (HC 679, 17 December 2015).

¹²³ Raf Sanchez, 'British Donations to Christian Charity World Vision were used to build a Hamas Military base in Gaza' *The Telegraph* (London, 5 August 2016) <https://www.telegraph.co.uk/news/2016/08/04/british-donations-to-christian-charity-world-vision-were-used-to/> accessed 1 March 2020.

for contravention of s5 of the Terrorism Act ¹²⁴ and the terrorist financing offence, entering into or becoming concerned in a terrorist financing arrangement contrary to s17 TACT 2000.¹²⁵ Two separate convictions (Syed Hoque and Mashoud Miah) were reported in December 2016, both for entering into a funding arrangements contrary to s.17 TACT 2000.¹²⁶

The Charity Commission publishes annual reports on their investigations and compliance casework, which could give an indication of the size of the problem within the sector. Considering the 3 reports from 2014-2015 to 2016-2017, it is clear that there is no consistent break down of incidents of terrorist financing. The earliest of the 3 reports indicates that 11 serious incident reports (SIRs) were made 'linked to terrorism' (two of which concerned charities having staff members or goods seized by terrorists) and 20 'causes of serious concern' in a category of assessment cases were attributed to 'alleged terrorism.' There were around 500 disclosures between the Charity Commission and law enforcement/other agencies (double the total for the previous year) amounting to 21.5% of the total.¹²⁷

In the 2015-16 report, the SIRs nearly doubled to 21, relating to abuse of charities 'for terrorist or extremist purposes' and 630 disclosures on this subject made between the Charity Commission and law enforcement/other agencies (approximately 27% of the total.)¹²⁸ In the 2016-2017 report SIRs 'with links to terrorism' numbered 19, representing a small reduction. The majority of these reportedly related to the acquisition of goods and resources by terrorist groups and allegations made against individuals either employed by or having some connection to a charity.¹²⁹ There were also a reduced number of disclosures compared to the previous year relating to 'terrorism and extremism' (506, which represents 21.5% of the total disclosures made).

¹²⁴ Terrorism Act 2006, s.5 prohibits the engagement in preparing for intended acts of terrorism.

¹²⁵ Charity Commission, Inquiry report (n 112).

¹²⁶ Charity Commission, 'Regulator publishes reports of cases involving individuals convicted of terrorist offences' (Press release, 16 October 2017).

¹²⁷ Charity Commission, 'Tackling Abuse and Mismanagement' 2014-2015, December 2015.

¹²⁸ Charity Commission, 'Tackling Abuse and Mismanagement' 2015-2016, December 2016.

¹²⁹ Charity Commission, 'Tackling Abuse and Mismanagement' 2016-2017, December 2017.

The statistical reporting in the 2019 publication offers less insight into incidents of abuse relating to terrorism, with no assessment of disclosures to other agencies in this matter, but 27 SIRs were made about 'links to terrorism' thus the numbers of reports appear to be rising.¹³⁰ There is scant information available as to the nature of the concerns reported or whether terrorist financing was an issue in particular.

The author therefore requested, under the Freedom of Information Act 2000, that the Charity Commission provide information regarding their investigations specifically relating to concerns over the financing of terrorism that either 1) directly concerned the charity itself or 2) concerned a charity suspected of having dealings with another organisation about which there were concerns relating to the financing of terrorism. A breakdown of these figures was also requested and, as a result of intervention, whether any of the following action was taken by the Charity Commission: directions were given; charitable status was withdrawn/charity closed; referral made to law enforcement or other agencies or no action was taken.¹³¹

The result was unsatisfactory as the author was merely referred to the published data, which provides no breakdown within the categories, which year to year are not measuring the same parameters or describing the same events. The Commission does not provide details on the disclosures, some of which may result from reports made by charities themselves in compliance with the requirement to report serious incidents, others will result from investigations initiated by the Charity Commission.

In a speech to charity lawyers, William Shawcross, then chair of the Charity Commission reportedly stated 'the Commission sees terrorist abuse as one of the greatest risks facing the charitable sector today', and went on to suggest that

¹³⁰ Charity Commission, 'Dealing with Wrongdoing and Harm: Lessons for Trustees', January 2019.

¹³¹ Request for information made by the author under the Freedom of Information Act 2000 to the Charity Commission on 17 March 2017.

funds could be vulnerable to abuse anywhere: ‘charities working in conflict zones are not alone at being at risk. Terrorists and extremist’s subversion of charity can take many forms and threaten any charity. Terrorists can exploit charity funding, misuse their assets or misuse their name’.¹³²

He shared his concerns of the potential exploitation of charities/aid groups by Islamists to get supplies to front line terrorists and syphon off funds that had originally been raised in Britain, and that there was ‘a risk’ that funds raised in Britain had already been sent to IS fighters.¹³³ In an interview he warned that the hijacking of charities by extremists is ‘not the most common problem we have, but it is potentially the most dangerous and deadly’.¹³⁴

Under the current leadership though, the rhetoric is certainly less inflammatory, and the publications emanating from the Charity Commission appear to focus on the duties of trustees as guardians of charity finances and offer practical advice as to what to be alert to, and how suspicious activity should be addressed.¹³⁵ The Charity Commission maintains that actual incidences of abuse in the sector have been rare, considering its size.¹³⁶ The potential threat of the abuse of NPOs for the purpose of financing terrorism though is undoubtedly the driving force for ever-present and increasing guidance issued by the Charity Commission, and the heightened recognition by the government that close collaboration with the Charity Commission is required to improve regulatory oversight of the sector.¹³⁷ The relationship that charities have with the Charity

¹³² Christopher Hope, ‘Terrorist Infiltration is one of the Greatest Threats to Britain’s Charities, says William Shawcross’ *The Telegraph* (London, 10 October 2013) <https://www.telegraph.co.uk/news/worldnews/middleeast/syria/10367377/Terrorist-infiltration-is-one-of-the-greatest-threats-to-Britains-charities-says-William-Shawcross.html> accessed 1 March 2020.

¹³³ Tim Ross and others, ‘Charity Commission: British charities Investigated for Terror Links’ *The Telegraph* (London, 1 November 2014) <https://www.telegraph.co.uk/news/worldnews/islamic-state/11203569/Charity-Commission-British-charities-investigated-for-terror-links.html> accessed 1 March 2020.

¹³⁴ Christopher Hope, ‘We Need a Charities Tax to Win Back Public Trust Says Charity Commission Boss’ *The Telegraph* (London, 31 December 2016) <https://www.telegraph.co.uk/news/2016/12/31/need-charities-tax-win-back-public-trust-says-charity-commission/> accessed 1 March 2020.

¹³⁵ For example, Charity Commission, ‘Dealing with Wrongdoing and Harm: Lessons for Trustees’ January 2019.

¹³⁶ Charity Commission, Compliance Toolkit (n 82) ch 1 module 3.

¹³⁷ For example, ‘Amber Rudd, Extremism: Written Statement’ 12.7.2017 (n 121).

Commission is therefore very relevant to this discussion. Issues such as how this may affect their understanding of the regulation as well their level of compliance is explored in Chapter Eight.

5. THE ROLE OF THE FINANCIAL SERVICES SECTOR

5.1 The 'follow the money' doctrine: Financial intelligence (FININT) shaping the UK response

The evolution of the 'economy of terror' outlined in Chapter Three, and the shift towards financially independent and autonomous terror cells has meant that typology analysis (the follow the money doctrine) from individual terrorist attacks is increasingly relevant to inform the development of counter-measures to adjust to this change in terrorist modus operandi.

The changing regulatory landscape since 9/11 has necessitated a reconfiguring of the provision of financial services. Reliance on banks to act as global police and to guard financial borders against financiers of terrorism is increasing. Easy access to bank current accounts, which can also be accessed remotely, means that money can be stored, and transferred to its destination without arousing suspicion. This means that banks are open to abuse as conduits for terrorist financing, and the movement of small amounts by several money mules or cash couriers can have a cumulative effect, with significant sums being made available for terrorists.

Retail banks face the challenge of having to instigate and maintain adequate controls on new customers and maintain ongoing account monitoring on a proportionate risk sensitive basis. Cash-intensive businesses, for example, could pose particular problems from the monitoring standpoint and can leave the bank open to abuse from criminals laundering money and financiers of terrorism.¹³⁸

¹³⁸ HMT/HO, NRA 2015 (n 9).

Correspondent banking has also been open to abuse; its vulnerabilities lie partly in the lack of direct relationship with the underlying parties to the transaction and the complex, often multinational nature of the relationships involved.¹³⁹ Furthermore, trade finance, with complex transactions often involving multiple participants, with banks unable to view the entire process displays vulnerabilities. Controls and systems in the banking sector designed to mitigate the risk of ML/TF in this field were deemed inadequate.¹⁴⁰

It has been recognised that in an era of increased globalisation and opportunity, terrorist groups have also become more sophisticated in their use of the financial system. However, their use of the system to store and move funds can prove to be their greatest vulnerability, providing valuable intelligence as well as evidence leading to prosecution.¹⁴¹

The financial services sector in the UK, with London at its core, provides employment for 1.1 million people (over 3% of the total job market). This sector (together with the insurance sector) contributed £132 billion to the UK economy in 2018 (nearly 7% of the total domestic economic output),¹⁴² which underlines its importance to both the employment market and the economy. It has been accepted that ‘the same factors that make the UK an attractive place for legitimate financial flows can make it attractive for money laundering’.¹⁴³ With the knowledge too that terrorists use the financial system to finance their activities, it became imperative that private actors within the financial sector were closely involved in the CTF regime, working with the public sector actors to deter and detect terrorist use of the system. The banking sector is a particularly valuable source of intelligence. 85% of personal current accounts

¹³⁹ HMT/HO, NRA 2017 (n 10) 33.

¹⁴⁰ Financial Conduct Authority ‘Banks’ Control of Financial Crime Risk in Trade Finance’ (Thematic review, FCA July 2013).

¹⁴¹ HMT, The Financial Challenge to Crime and Terrorism (n 11).

¹⁴² Chris Rhodes, ‘Financial Services: Contribution to the UK Economy’ (House of Commons Briefing Paper no.6193, 31 July 2019)

¹⁴³ HMT/HO, NRA 2015 (n 9).

were held within only 5 retail banks in the UK (in 2014)¹⁴⁴ and, for agencies responsible for gathering intelligence, establishing a good working relationship with these institutions is key.

Whilst Levi agrees that the financial requirements of recent terror cells are now unexceptional, he considers that the utility of any regime set up to identify financial terrorist activity has to be questioned. The evolution of CTF regulation is described as ‘a net widening of intelligence from ever-increasing parts of the private sector in a desperate search for information...in the face of multifarious sources of finance, few of them readily distinguished from normal business or charity or from normal low-level criminality.’¹⁴⁵

5.1.1 Suspicious Activity Reports (SARs)

Access to detailed financial data generated under the compliance protocols for AML under the umbrella of customer due diligence (CDD) is becoming increasingly key to FININT, and a vital component of CTF strategy.¹⁴⁶ The requirement for CDD, as previously discussed in relation to charities’ obligations, places institutions under an obligation to both identify and to understand the nature of their relationship with customers. The latter requirement is an ongoing commitment which could provide valuable intelligence, alerting the organisation if there were any changes in behaviours, which may arouse suspicion.¹⁴⁷

The regulatory response post 9/11 imposing additional financial defence measures on banks were, according to Ridley, ill-conceived, and caused

¹⁴⁴ Statista, ‘Market share of current accounts of leading UK banks in 2014’ 26 November 2014 <https://www.statista.com/statistics/387098/uk-banks-current-account-market-share> accessed 13.8.2019 accessed 1 March 2020.

¹⁴⁵ Michael Levi, ‘Combating the Financing of Terrorism: A History and Assessment of the Control of “Threat Finance”’ (2010) 50 *British Journal of Criminology* 650, 658.

¹⁴⁶ For example, in accordance with the Directive (EU) 2015/849 (4th Money Laundering Directive) member states are required to ‘prohibit’ money laundering and terrorist financing activities and to ‘require’ relevant persons in the private sector to carry out due diligence.

¹⁴⁷ Robert Stokes, ‘Anti-Money Laundering Regulation and Emerging Payment Technologies’ (2013) 32(5) *Banking and Financial Services Policy Report* 4.

considerable economic damage to the financial system. Compliance costs escalated, with no commensurate benefit to the CTF effort.¹⁴⁸ The role of the regulated sector in the implementation of financial crime policies has been described as that of the ‘private police.’ Supervisory authorities, (for example the FCA, with authority to investigate and prosecute)¹⁴⁹ are positioned between this private sector and the public police (law enforcement agencies.)¹⁵⁰ Eckert also questions whether the regulatory approach placing such emphasis on the financial sector, is still appropriate given that terrorists have alternative means of funding their activities, including dealing in cash and the use of charitable donations.¹⁵¹

A considerably more mature CDD regime however is currently in place which nevertheless continues to exert significant pressure on the sector. The FCA with regulatory powers under the Financial Services Act 2012 created a new regulatory framework for financial services. There is a requirement to identify and assess the risk of ML/TF taking into account guidance available (for example from the regulator/Joint Money Laundering Steering Group (JMLSG), and risk factors relating to clients, the particular services/products offered and geographical area of operation as well as the delivery channels.¹⁵²

The Money Laundering Regulations (2017) introduced several key changes.¹⁵³ The regulation regarding risk assessment is more prescriptive than previously, requiring an analysis of the potential ML/TF exposure addressing the above-mentioned risk factors. Other major changes include creation of a ‘blacklist’ of high-risk jurisdictions, prospective dealings with which would trigger compulsory enhanced due diligence. A new criminal offence is created by the

¹⁴⁸ Ridley (n 13) 58.

¹⁴⁹ Under the Money Laundering Regulations 2007, SI 2007 2157.

¹⁵⁰ Mo Egan, ‘The Role of the Regulated Sector in the UK Anti-money Laundering Framework: Pushing the Boundaries of the Private Police’ (2010)6 (2) *Journal of Contemporary European Research* 272, 280.

¹⁵¹ Sue Eckert, ‘The US Regulatory Approach to Terrorist Financing’ in Thomas Biersteker and Sue Eckert (eds), *Countering the Financing of Terrorism* (Routledge 2008) 224.

¹⁵² JMLSG, *Prevention of Money Laundering/Combating Terrorist Financing: Guidance for the UK Financial Sector* (13 December 2017).

¹⁵³ Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, SI 2017 692.

regulations, punishable by a fine and/or up to 2 years imprisonment any individual who makes a statement “reckless as to whether the information is false or misleading.”¹⁵⁴

Failure to comply with AML/CTF regulation attracts severe penalties. The FCA fined Deutsche Bank over £163 million, the largest financial penalty it has ever imposed, for failure to comply with AML regulation and putting itself and the UK at risk of being used to facilitate financial crime. Its reported failings included inadequate due diligence with respect to customers and using flawed risk rating procedures.¹⁵⁵

Financial institutions and other regulated bodies are under a legal obligation to report suspicious financial transactions, or any other suspicious activity suggesting that an offence has been committed.¹⁵⁶ The reporting obligations have been widely criticised as creating undue fear amongst the regulated sector. Although some of the fear of civil liability may be allayed by the provisions of the Serious Crime Act 2015(s37),¹⁵⁷ the number of reports to FIU’s globally have increased significantly: an implicit consequence of the ‘fear factor’ in operation.¹⁵⁸

Over 478,000 SARs were reported to the UK Financial Intelligence Unit (UKFIU) in 2019.¹⁵⁹ From a base of approximately 15,000 SARs/year in the six years to 2000, the figures doubled in 2001 and again in 2002 to 63,000,¹⁶⁰ steadily increasing in number since then. The general increase in SARs pertaining to terrorist financing (although this was down from 2,688 to 1909 in the last

¹⁵⁴ *ibid* s.88 (1)(b).

¹⁵⁵ FCA, ‘FCA Fines Deutsche Bank £163 Million for Serious Anti-money Laundering Controls Failings (FCA 31 January 2017) <https://www.fca.org.uk/news/press-releases/fca-fines-deutsche-bank-163-million-anti-money-laundering-controls-failure> accessed 1 March 2020.

¹⁵⁶ POCA 2002 and TACT 2000, for example.

¹⁵⁷ Serious Crime Act 2015 s.37 Enhanced protection is provided to reporters in the form of statutory immunity from civil liability where SARs are submitted in good faith.

¹⁵⁸ *Ryder* (n 12) 120.

¹⁵⁹ National Crime Agency, ‘Suspicious Activity Reports (SARs) Annual Report 2019’.

¹⁶⁰ KPMG, ‘Money Laundering: Review of the Reporting System’ (KPMG 2003) 15.

reporting period¹⁶¹) may reflect the increase in reporting overall, and enhanced methods of isolating material specifically relevant to terrorist financing.

The expense to the private sector in complying with the statutory requirements is a major criticism.¹⁶² The banking sector has by far been the largest overall contributor to the total SARS submitted (over 80% in the year to September 2019.) The next largest contribution has been from Building Societies (at 4.54% in the same time period.)¹⁶³ Failure to comply with the reporting requirements carries potential criminal liability, with a maximum of 5 years imprisonment or a fine or both,¹⁶⁴ which is in excess of penalties available for breach of other AML regulations.

The utility of the SARS regime has been called into question in some quarters; Chaikin for example argues that the measurement used to judge the efficacy of the system is flawed.¹⁶⁵ This observation was also made by a House of Lords Committee, commenting on the fact that financial institutions were required to spend large sums on compliance (one bank reportedly spending £36 million in one year), with no cost benefit analysis having been carried out at any level.¹⁶⁶

The Government sought to ascertain whether there was evidence of over-implementation and ineffective AML/CTF requirements imposed on businesses. (The review did not solicit comment relating to the burdens associated with suspicious activity reporting.)¹⁶⁷ Evidence of confusing written guidance from the FCA, and FCA supervisors following a tick box rather than a risk-based approach was noted. Furthermore, banks reported their over-compliance with

¹⁶¹ NCA, SARs Annual Report 2019 (n 159).

¹⁶² Jackie Harvey, 'Compliance and Reporting Issues Arising for Financial Institutions from Money Laundering Regulations: A Preliminary Cost Benefit Study' (2004) 7 *Journal of Laundering Control* 333,343.

¹⁶³ NCA, SARs Annual Report 2019 (n 159).

¹⁶⁴ POCA s.334.

¹⁶⁵ D Chaikin, 'How Effective are Suspicious Activity Reporting Systems?' (2009) 12 *JMLC* 238, 243.

¹⁶⁶ House of Lords EU Committee, *Money Laundering and the Financing of Terrorism* (19th Report of Session 2008-2009 HL Paper 132-I, July 2009).

¹⁶⁷ HM Government, 'Cutting Red Tape: Review of the UK's Anti money Laundering and Counter-financing of Terrorism Regime' March 2017.

CDD checks in an effort to appease regulators and a distinct reluctance for them to challenge supervisors' findings even if they appeared illogical.¹⁶⁸ The British Bankers Association (BBA), calling for reform, stated that the current system of requirements on the banking sector potentially had a negative impact on the service they were able to provide to legitimate clients, as well as affecting access to banking for business customers. 'The costs of financial crime compliance for the British banking industry have gone beyond the 'tipping point' in comparison with the AML/CTF benefits accrued was the stark message.'¹⁶⁹

The Head of the FCA also recognised the high cost of compliance and questioned, given that 'each SAR you submit is the product of thousands of pounds worth of work' (Based on estimates of compliance costs by the BBA and others) 'is the average SAR yielding thousands of pounds-worth of intelligence to the authorities? Would the police spend thousands from their own budget to get the information in the typical SAR?'¹⁷⁰ Expressing support to reduce compliance costs he also suggested longer-term reforms and questioned whether criminal liability attached to the regulation was leading to defensive reporting and thus muddying the waters for law enforcement agencies.¹⁷¹

The NRA identified that reform of the SAR regime was necessary, and the HM Treasury Action Plan, published in 2016, acknowledged that re-focus on the regime to target individuals/entities based on risk rather than transactions was needed.¹⁷² Whether this 're-focus' will have any effect on the confidence with which it relates to the charity sector remains to be seen.

Whilst acknowledging the difficulties associated with making any meaningful estimate of the impact on crime attributable to SARs, Fleming points to the contribution that SARs make to 'knowledge discovery'; that the value of this

¹⁶⁸ *ibid.*

¹⁶⁹ BBA, 'Response to Cutting Red Tape Review The Effectiveness of the UK's AML regime' (BBA 6 November 2015).

¹⁷⁰ Rob Gruppetta 'Effectiveness and Proportionality: Our Financial Crime Priorities' (Speech given at FCA Conference November 2016).

¹⁷¹ *ibid.*

¹⁷² HMT/HO, 'Action Plan for Anti-money Laundering and Counter-terrorist Finance', April 2016.

regime lies in their contribution to intelligence and in furthering criminal investigations. This could involve identifying the activity of known terrorists or identifying certain assets that can then be seized and confiscated. The added value is in providing intelligence that would not be obtained otherwise.¹⁷³ The utility of SARs with respect to terrorist financing was also confirmed recently by the NCA, reporting that they had provided vital intelligence in the investigations into the Manchester Arena and London terrorist attacks in 2017.¹⁷⁴

5.2 The question of risk

Both the assessment and management of risk are essential in the provision of banking services. The ‘possibility’ that risk would be present was traditionally accepted, according to the BBA, or otherwise it was viewed as a ‘probability’ which required control and mitigation, rather than to be avoided altogether.¹⁷⁵ The enhanced regulatory oversight, as well as negative media coverage as a result of the 2008 financial crisis created a climate of increased wariness with regard to risk-taking within the sector in the US.¹⁷⁶

This paradigm shift in risk perception has also been noted by the BBA with respect to the domestic sector. Some of the challenges reported by banks included; the escalating cost of risk management which had, in some cases, become unquantifiable; the decrease in perceived tolerance for unintended breaches of the regulation; and the lack of agreement on a global level pertaining to risk tolerance between the various stakeholders: governments, regulators and the private sector.¹⁷⁷ The default position of enhanced due diligence advocated by regulators and FATF guidance alike is in practice, according to the BBA, tipping the balance of customer needs and financial crime

¹⁷³ Matthew Fleming, ‘Issues in Measuring the Efficacy of a SAR Regime’ *Amicus Curiae* Issue 70 Summer 2007.

¹⁷⁴ National Crime Agency, ‘Suspicious Activity Reports (SARs) Annual Report 2018’.

¹⁷⁵ British Bankers Association, ‘BBA Roundtable on Financial Exclusion/Stability Arising from Financial Crime Related De-risking’ 4 March 2014.

¹⁷⁶ Eckert (n 2).

¹⁷⁷ BBA (n 175).

detection/ prevention towards erring on the side of caution and consequent diminution in risk appetite.¹⁷⁸

There has been recognition in recent years that the severing of banking relationships with charities as a consequence of de-risking decisions has had a profound effect on the ability of certain charities to operate.¹⁷⁹ Initially the problem of restricted financial access was reported to affect mainly Muslim charities, but this trend has now extended to other faith-based and secular charities operating internationally and domestically.¹⁸⁰ Other commentators however indicate that Muslim charities, or those with a reference to Islam or to Syria for example, have been subjected to greater obstacles,¹⁸¹ which underlines the nervousness with which many banks approach charities. The analysis of the interview data, presented in Chapter Seven, also suggests that the issue of bank de-risking has had a significant effect on the operating capability of some charities, and that Muslim charities in this respect may be particularly affected.

5.2.1 Money service businesses-an exceptionally risky business?

The risk of terrorist financing within The MSB sector was assessed in the 2015 NRA to be high. Key threats included; a low rate of reporting; employees within the sector facilitating terrorist financing; and exploitation by terrorists of the facility available which enabled remittance of funds to be made without proof of identity for sums under 1000 euros.¹⁸² This potential loophole allowing the transmission of large numbers of small amounts of funds using different MSBs, was subsequently closed.¹⁸³ The NRA in 2017, however, reported that links to high-risk areas, which is often the reason why they have proved invaluable for

¹⁷⁸ *ibid.*

¹⁷⁹ For example, Eckert (n 2): Artingstall and others (n 4): OBM Watch/Grantmakers Without Borders, 'Collateral Damage: How the War on Terror Hurts Charities, Foundations and the People They Serve' (July 2008) 32.

¹⁸⁰ Tom Keatinge, 'Uncharitable Behaviour' (Demos 2014) 41.

¹⁸¹ Stuart Gordon and Sherine El-Taraboulsi-McCarthy, 'Counter-terrorism, Bank De-risking and Humanitarian Response: A Path Forward' (OBM August 2018).

¹⁸² HMT/Home Office, NRA 2015 (n 9) 93.

¹⁸³ HMT/Home Office, NRA 2017 (n 10) 71.

remittances for overseas workers, for example, was a factor influencing the rating as 'high' for terrorist financing risk.¹⁸⁴

The UK MSB sector is exceptional in size. The BBA reported that banks were finding MSBs particularly problematic and that more systematic monitoring on their part was flagging up increased levels of alerts, creating more 'known risk.' The current lack of even the most basic regulation of MSBs in many countries has exacerbated the problem, and 'de-risking' with regard to this sector is expected to continue.¹⁸⁵ The social impact of this has been profound.

The interpretation and implementation of CTF regulation regarding MSBs has been associated with a negative impact on NPOs. In 2013, for example, there were well-publicised reports of MSB accounts being closed, and the following year the problem of the withdrawal of financial services from NPOs (as well as foundations and associated persons globally) became apparent.¹⁸⁶ The problem for NPOs does not appear to have diminished, as highlighted earlier in this discussion.

5.3 The chilling consequences of non-compliance and regulatory breach

Banks operating in an international environment may be affected by the consequences of others non-compliance. For example, when the offshore banking sector of the Republic of Nauru, one of the smallest nations in the world, was abolished in 2004 and had no operational bank, the only financial institution remaining offering financial services was a Western Union remitter operating from a hardware store.¹⁸⁷ The complete collapse of the financial system is directly attributed to the effects of the FATF blacklisting and consequent financial blockade by private institutions that, even after the country had complied with the FATF's demands, were unwilling to risk their

¹⁸⁴ *ibid.*

¹⁸⁵ BBA (n 175).

¹⁸⁶ Keatinge (n 180) 79.

¹⁸⁷ FATF, Asia/Pacific Group on Money Laundering, 'Mutual Evaluation Report: Money Laundering and Combating the Financing of Terrorism' (FATF/OECD July 2012).

reputation by opening a branch there.¹⁸⁸ This only changed when the Australian Bendigo bank opened an agency, reportedly in the spirit of offering financial inclusion to its citizens after years of effective exclusion from banking services.¹⁸⁹

The risk appetite of banks is also undoubtedly affected by the sobering reality of substantial fines for regulatory breaches, either from their own experience or from the experience of other institutions. In 2012, HSBC narrowly escaped criminal prosecution for allowing money laundering by terrorists and drug dealers in its Mexican businesses. George Osborne and the Financial Services Authority (FSA) intervened, fearing it would trigger a global financial disaster. The bank paid US\$ 1.9 billion in fines for its admitted failures, which also included the violation of US sanctions in several jurisdictions including Iran and Libya.¹⁹⁰ The lessons from HSBC serve as a warning to the rest of the sector and would undoubtedly have a dampening effect on risk appetite. The risk and compliance department at HSBC expanded rapidly following this debacle; employing 24,300 staff in 2014, with compliance costs amounting to US \$750-800 million; a 24%- 33% rise from the previous year.¹⁹¹

The Standard Chartered Bank also felt the effects of US regulation in 2012 when criminal charges were brought against the bank for moving billions of dollars in breach of sanctions imposed on Iran, Syria and Sudan. The bank has reportedly paid almost \$1 billion in settlement of these cases. In addition, it was placed under supervision by an independent monitor, expecting to remain so for several years, under a differed prosecution agreement (as was HSBC.)¹⁹²

¹⁸⁸ Jason Sharman, 'Power and Discourse in Political Diffusion: Anti-Money Laundering in Developing States' (2008) 52(3) *International Studies Quarterly*, 645.

¹⁸⁹ Bendigo Bank, 'Response to our Bank's presence in Nauru' 21 April 2016 <https://www.bendigobank.com.au/public/news-and-media/news/news-archive/response-to-our-banks-presence-in-nauru> accessed 1 March 2020.

¹⁹⁰ Rupert Neate, 'HSBC Escaped US Money Laundering Charges after Osborne's Intervention' *The Guardian* (London, 11 July 2016) <https://www.theguardian.com/business/2016/jul/11/hsbc-us-money-laundering-george-osborne-report> accessed 1 March 2020.

¹⁹¹ M Arnold, 'HSBC Wrestles with Soaring Costs of Compliance' *Financial Times* (London, 4 August 2014).

¹⁹² Gavin Finch and Edward Robinson, 'Why Banks are cutting off charities' (Issue 4475, Bloomberg Businessweek 16 May 2016) 18-20.

The fine imposed amounted to \$340 million. The bank was obliged to set up a financial crime risk mitigation programme as part of the agreement with the Department of Justice. Furthermore, millions of dollars were expended on upgrading the bank's technology systems to conform to robust US standards, as well as on investments in personnel to manage the systems and generally comply with the regulation imposed.¹⁹³

In the US civil lawsuits have been pursued through the courts under the Anti-Terrorism Act: the Jordanian Arab Bank, for example, found liable for supporting terrorist acts in the vicinity of Israel by handling bank transactions for members of Hamas. (Money was also allegedly channelled to relatives of terrorist suicide bombers from Saudi charities via the bank.) The bank's support was proven to be the 'proximate cause' of the terrorist acts, with the ensuing personal injuries considered 'reasonably foreseeable.'¹⁹⁴ The effect of such litigation serves to dampen risk appetite globally and further affects the attitude of banks (including in the UK) to providing services to charities in unstable geographical areas.

The majority of UK based banks also operate outside the jurisdiction. Payments in US dollars that are initiated outside the US and destined for localities other than the US are nevertheless cleared via the US banking system. These banking transactions are therefore subject to US regulation with respect to sanctions imposed by the US. UK banks operating in the US have an obligation to justify all transactions destined for countries under the US sanction regime, irrespective of where the funds originate, their final destination or indeed the currency being transferred.¹⁹⁵ There is the perception within the banking sector that widening US jurisdiction may reach out to UK firms who rely on access to the US

¹⁹³ Laurence White, and Suzanne Barlyn, 'StanChart Faces Extension of US money-laundering Vigilance' *Reuters* (2 September 2016) <http://uk.reuters.com/article/uk-hsbc-stanchart-compliance-idUKKCN118223> accessed 1 March 2020.

¹⁹⁴ Stephanie Clifford, 'Arab Bank Reaches Settlement in Suit Accusing it of Financing Terrorism' *New York Times* (New York, 14 August 2015) <http://www.nytimes.com/2015/08/15/nyregion/arab-bank-reaches-settlement-in-suit-accusing-it-of-financing-terrorism.html> accessed 1 March 2020.

¹⁹⁵ Charity Finance Group, 'Written Evidence Submission: Home Affairs Select Committee-Counter-terrorism Inquiry' September 2013.

markets. Banks have consequently become more circumspect when it comes to deciding to whom they will offer their services, fearing the consequences of extra-territorial reach in the form of fines imposed by US regulators, and judicial proceedings.¹⁹⁶

The Charity Commission highlights the importance of charities using formal banking channels to store and transfer their funds. Trustees have a legal obligation to protect their charity's assets and generally exercise proper control over the charity's financial affairs. As such 'It is difficult to see, where regulated banking systems are available, how trustees could show they discharged this duty if they did not use them'.¹⁹⁷ Formal banking channels however are not available to all charities in all circumstances, which has been particularly problematic for international humanitarian charities operating in challenging circumstances.

6. CONCLUSION

The experience gained in confronting terrorism in Northern Ireland, as well as inspiration drawn from drug trafficking legislation, and the link between organised crime and terrorism, provided opportunities to borrow from the existing UK regulatory framework. A well-developed CTF regime has emerged post 9/11, relying heavily on private sector partnerships such as financial institutions to provide financial intelligence to law enforcement agencies. Featuring prominently within this legal framework is the targeting of financial assets of terrorists by means of an asset freeze regime.

Obligations on institutions to identify and understand their customers, and any others with whom they may have a professional relationship, require trustees in the charity sector carry out due diligence both in compliance with charity law as custodians of their charity, but also on a personal level, in common with other 'employees' in compliance with legislation such as the TACT 2000.

¹⁹⁶ Artingstall (n 4).

¹⁹⁷ Charity Commission, Compliance Toolkit (n 82) ch 4 9.

The size of the problem of terrorist financing within the charity sector is very difficult to assess. The discussion in this chapter, of the perceived risk of this occurring within the sector is taken further in the forthcoming chapters to ascertain whether this perception is shared by participants from charities and other stakeholders, to address questions of proportionality of the response. The requirements of the regulation and some of the implications of implementing this have been discussed in this chapter; placing a burden on some charities but not others, in accordance with the risk- based approach. The question of charities' awareness and understanding of the regulation and engagement with it will be discussed in the next chapter. The position of the regulator is also central to the discussion; the relationship with the charity sector; issues of unfair bias against Muslim charities in particular; and whether the regulator is perceived by commercial partners, such as banks, as being sufficiently robust, which may affect their willingness to provide their services.

This chapter has also focused on the banking sector as an example of public/private partnership; its role in the provision of financial intelligence and the requirements to contend with expanding definitions of financial crime, freeze assets, enforce sanctions, monitor transactions as well as comply with the onerous reporting requirements placed upon it. Lack of direction from policy makers as to what is reasonable to expect from financial information places an additional burden upon financial institutions. The visibility of such intelligence gathering meets the requirement that 'something must be done'.¹⁹⁸ The cost of providing the intelligence though, is difficult to assess as AML and CTF are often tackled together, however the cost of 'getting it wrong' both in financial and reputational terms can be immense.

Having considered the UK CTF framework, it is apparent that there have been unintended consequences flowing from implementation of the regulation within the charity and financial services sectors. For both, the requirements of the

¹⁹⁸ Levi (n 145) 658.

regulation have necessitated enhanced due diligence procedures when transferring funds for humanitarian purposes, where the risk of terrorist financing may be heightened. Charities require banking services, and indeed are strongly advised to use regulated financial channels to both store and transfer funds. For some banks though, dealing with certain high-risk entities falls outside their risk profile, and charities have fallen victim to this trend, with some reports indicating that Muslim charities in particular have encountered problems with their banking relationships.

The analysis of participant responses presented in the forthcoming chapters highlights further the issues that affect the relationship between charities and financial institutions generally in relation to matters of regulatory compliance, as well as more specifically the consequences of bank de-risking. The scale of the problem of bank account closures is unclear. Furthermore, prior research concludes there is little evidence to determine the nature of relationships exited,¹⁹⁹ therefore it was considered important to address these issues in the empirical research.

The Charity Commission is empowered to interpret the ambiguous recommendations emanating from the FATF. In its 4th round Mutual Evaluation Report the UK was assessed as having met all relevant criteria for compliance with Recommendation 8.²⁰⁰ The increased guidance and practical advice for charities from the Commission with respect to terrorist financing also indicates that the potential for this financial crime to affect charities is taken seriously. The question of whether this amounts to definitive action and accountability in a practical sense is explored in discussions with participants with respect to their engagement with the Regulator in Chapter Eight.

¹⁹⁹ See previous comments, Chapter One s.3.

²⁰⁰ FATF, 'Anti-money Laundering and Counter-terrorist Financing Measures-United Kingdom Mutual Evaluation Report' (FATF/OECD December 2018).

CHAPTER 6: ENGAGEMENT WITH THE REGULATION: A QUESTION OF AWARENESS AND RESPONSE

1. INTRODUCTION

The regulatory environment in which many charities operate is increasingly complex, as discussed previously.¹ The non-profit sector is considered vulnerable to abuse for terrorist financing purposes, although the extent to which this is true continues to divide opinion.² Nevertheless, prior research indicates that financial risk awareness and management within charities is variable and in some cases poor.³ The level of understanding of what it takes to comply with the CTF regulation, the willingness of charities to engage with it, and consequences of non-compliance have also been highlighted previously in Chapter Five s.4.

The objective of this chapter is to discuss the responses of the participant organisations with regard to their engagement with and implementation of the regulation, and to address the research questions; How are the regulations implemented in practice? What are the implications for the organisation of implementing and complying with the regulation? And to what extent does the regulation impact on the operations of charities?

Charity trustees have a legal duty to advance the purpose of the charity and are collectively responsible for its proficient administration, including the protection of the charity's assets. The Charity Commission advises that trustees take a risk-based approach to the level of due diligence they consider should be applied to donors, beneficiaries and partners as well as the monitoring mechanisms to ensure charity funds are used as intended by the charity. The action taken by trustees should therefore be proportionate and reasonable.⁴ As

¹ For example, Chapter Three s.3: Chapter Four s.5.

² See Chapter 3 s.2.: In the domestic arena, Chapter Five s.4.3.

³ Chapter One s.2.

⁴ Charity Commission, 'Compliance Toolkit: Protecting Charities from Harm' September 2016 ch 2.

mentioned in Chapter Five, (s.4.2.3) trustees and employees have a statutory obligation to report suspicious activity. There is also a statutory duty under charity law to report to the Charity Commission with regard to serious incidents. Further requirements of the regulation, and expectations regarding compliance, may include measures such as consulting sanctions lists to ensure the charity is not linked with known terrorists or proscribed organisations. Other relevant measures could include assessing the risk of bribery, and to have anti-bribery procedures in place if necessary.

Some of the factors (predominantly internal) which may influence the level and manner of response from organisations to the regulation will be considered in the first part of the chapter. During the interview process the influence of internal factors surfaced to some degree in all the interviews and was explored further where appropriate. In the analysis of the interview data key factors and themes concerning engagement with the regulation were identified in answer to the research questions. Having established these themes the researcher was then able to build upon this and form an opinion about the individual organisation's engagement with the regulation, and the categorisation of the organisations into four ideal types/alternative paradigms, which typology will form the basis of the framework for analysis.

In the second part of the chapter this analytical framework is introduced, which serves as a lens to compare, contrast and analyse the interview data and to determine the extent to which the legal framework is effectively implemented. This will also lead to a discussion, at the end of each category, of the impact that the legal requirements have on charities, and the extent to which the regulatory burden has affected the ability of charities to pursue their charitable purpose.

2. FACTORS INFLUENCING THE LEVEL AND MANNER OF RESPONSE FROM PARTICIPANT ORGANISATIONS

2.1 The role of the trustee and Influence on management

The role of the trustee is non-executive, but trustees are ultimately collectively responsible for the administration of their charity. Prior research has

highlighted the problem evident in some charities, that trustees have a poor understanding of their roles and responsibilities, and the competence of trustees has been called into question.⁵

Some trustees reported feeling out of their depth and unsure about their role, thus their ability to fulfil the role could be called onto question. A specialist in charity accounting made the following observation with respect to her client base:

We quite often see people becoming trustees and then resigning after a fairly short time because they have just realised what it is, and what is being asked of them. (Interview 29)

Many trustee participants cited the vast array of regulation that trustees are now obliged to consider as adding significantly to their burden of responsibility, and possibly influencing their decision to take up such a role:

It's not putting people off coming in working in the sector (the regulation) but it's probably putting people off being trustees... I would think what am I signing up for? And the real worry is, I don't know what I don't know anymore, and that's what I'm scared about. (Interview 10)

I am sure regulation in the financial field has had an effect of putting off trustees, but I think regulation in general has increased and there is a huge increase in what you are responsible for; it's massive. (Umbrella organisation-Interview 11)

Some trustees in the participant group were obviously uncertain as to their responsibilities. The organisation's position on delegation of the responsibility of trustees should be clear from the governing document, which generally permits delegation of certain powers, for example to employees who are expert in their field. As the trustees collectively retain ultimate responsibility, they should be clear as to their role and how employees and management fulfil the objectives of the charity and ensure that proper processes are in place. Participant trustees did not always demonstrate a clear understanding of their

⁵ 'Institute of Chartered Accountants in England and Wales (ICAEW), ICAEW and Charity Commission Review Project' (2014).

role, and the relationship between trustees and management with respect to the regulation was in some cases confused:

I suspect there is probably more we could do I have to say. I don't know the detail of what, even if we do have any responsibilities here (with reference to due diligence). It's one of those things I'm not sure what they are ... I think there are people within the charity that know what they're doing, and there has to be a certain level of trust. (Trustee of large charity- Interview 16)

Hyndman and McDonnell in their consideration of the role and responsibilities of trustees note the perspective of charity chief executives that the trustee role should be essentially strategic in nature, and board membership should reflect a wide range of skills and experiences to maximise the performance of the charity. A partnership approach is taken to trustee/management relations within some organisations, whereas a high level of control asserted over management may be evident in others, which may be the source of conflict.⁶ The chair of the RNIB charity considered that there was a more fundamental problem with the role of trustees in that, despite having the responsibility to hold management to account, they consistently neglected to do so. Such dereliction of duty amounted to 'cowardice', which effectively would 'make a nonsense of any call to good governance'.⁷

There were certainly tensions between trustees and management expressed in some of the interviews, and a lack of understanding of each other's roles. The finance director of a medium-sized charity, for example, commented:

To be quite honest I think we (the management) are more aware of their responsibilities than the actual trustees themselves. (Interview 15)

A further incidence of tensions between trustees and management were reported by a medium-sized charity in which the board consisted exclusively of

⁶ N Hyndman and P McDonnell, 'Governance and Charities: An Exploration of Key Themes and the Development of a Research Agenda' (2009) 25 (1) 'Financial Accountability and Management' 5, 22.

⁷ Rob Preston, 'Most Charity Failures are Due to Trustee Cowardice, says RNIB Chair' (*Civil Society*, 24 July 2017) <https://www.civilsociety.co.uk/news/most-charity-failures-due-to-trustee-cowardice-says-rnib-chair.html> accessed 1 March 2020.

trustees who were volunteers within the organisation. They were involved in day-to-day operations rather than providing strategic guidance, and this affected the perception of their own role, and the perception of their role by the management.

The chair of the board of trustees highlighted a situation that he described as 'unfortunate' in which the prevailing culture facilitated the recruitment of trustees exclusively from within the organisation. There had been an occasion when the number of trustees fell below the minimum required by the constitution, so the constitution of the charity was changed to accommodate the reduced number, rather than advertise externally for suitable candidates. The participant was advocating external recruitment in order to obtain a more diverse, relevant skill set than could be found within, but had met with significant opposition from the trustees. (Interview 23)

Trustees are in a unique position in that they have a responsible role, for which in the main there is no remuneration. The attitude of trustees to compliance with regulation differed greatly within the participant group, with some viewing their role as a volunteer within the organisation from which they could resign at any time:

I think there is a feeling, rightly or wrongly, amongst some trustees that they are volunteering, they are here to do good, and therefore almost the general laws do not apply to them. (Umbrella group - Interview 12)

In some organisations the trustees took their responsibilities very seriously, especially those who felt that this role would reflect on their professional standing. The CEO of a major charity considered that training regarding their responsibilities was essential for trustees, for those newly appointed, but also on an ongoing basis in the form of annual reviews and periodic compulsory reading, including matters regarding due diligence and awareness of terrorist financing. (Interview 26)

Others cited examples of complacency, for example, a charity accountant commenting on some trustee clients:

...they don't really reflect on do they have the right skills. And they are more likely to be the ones who don't think more widely around the point we've been mentioning, so due diligence, vetting partners etc. (Interview 29)

There was wider evidence amongst the participants, of trustees exerting a positive influence on management with respect to the due diligence requirements, however there were also examples of trustees having no clear knowledge of management policies, even in large international organisations. (Interview 14 and 15) Clearly the lack of understanding of the role of the trustee was an issue for some of the participants which may influence compliance with regulation. If they do not envisage regulatory compliance as part of their role, the organisation may neglect this aspect of governance altogether.

2.2 Availability of information and expertise

Many participants felt they lacked expertise, especially in financial matters, to adequately comply with regulatory requirements, if indeed they were aware of them. Attracting trustees was not an issue for the mostly larger, prestigious charities, in the fortunate position of having a full complement of trustees from various professional backgrounds. According to the CEO of a major charity, such trustees were 'queuing up to take up the role,' which in many cases was to enhance their CV, such was the high esteem in which the charity was held. (Interview 26)

For the small/medium-sized charities, getting the balance of expertise required was often problematic. Many smaller charities stated that the presence of either a trustee or an employee with financial experience would influence their attitude to the regulation.

I think it has always been hard to get hold of treasurers because the job carries such an enormous weight, and they are very responsible. (Interview 11)

A recent report seeking to ascertain characteristics of trustees also found a skills gap. Although the survey did not mention money laundering or terrorist financing, nearly half the trustee respondents reported possessing few or only moderate skills with respect to fraud detection/avoidance. Skills gaps were thus evident in this area of financial crime.⁸ The availability and uptake of support for trustees will be discussed in more depth in Chapter Eight.

Charities are increasingly aware of the damaging effects of mismanagement. This affect may be felt by the charity, or on a personal basis for the trustees, and potentially too for the employers of trustees. For example, a firm of accountants discouraged one of the partners from taking up a role as trustee as they feared that any poor publicity attracted by the charity would have a negative impact on the firm. In other cases, it was the trustee who decided to resign rather than risk her reputation, thus depriving the charity of her expertise:

If the charity got something wrong it could affect her professional standing, so I think this is where some of the major problems are. What the charity is doing affects the person's professional standing. (Interview 16)

Even if there were no objection by the employer to an employee taking on a trustee role, it would be prudent for an individual to undertake his/her own due diligence on a charity, before making this decision. A participant from a firm of accountants specialising in charity accounts and audits declined an invitation to become a charity trustee as she felt that their precarious financial situation and poor standard of due diligence precluded her participation. Again, the charity was deprived of a source of expertise, in this case due to their own poor management. (Interview 29)

Negative media exposure in recent high-profile cases involving charities under investigation by the Charity Commission: Kids Company and Oxfam for example, was cited as having an adverse influence on potential trustees. Several

⁸ Charity Commission, 'Taken on Trust: the Awareness and Effectiveness of Charity Trustees in England and Wales' (November 2017).

participants considered this had a direct impact on the willingness of individuals to offer their services as trustees; as highlighted by the CEO of a large charity:

... although as individuals they might be interested, they are nervous that something might go wrong and it would affect their professional status, or their employers don't want them to do it, so I think it is having a bearing, and Kids Company has been specifically mentioned in at least two of those events. (Interview 9)

For some charities, updating their trustees on developments in the regulation took place on an annual basis and they were offered comprehensive training programmes, as mentioned earlier (Interview 26.) However, for many others there was a distinct lack of information and advice available, and as a consequence they felt unprepared to meet the requirements of the regulation.

2.3 Cost Issues

Many participants raised the issue of cost as a factor influencing compliance. For large charities, whether operating overseas in unstable environments or exclusively domestically, robust policies and procedures would already be in place. Focusing specifically on terrorist financing may be an additional cost, but one considered both proportionate in relation to the size of the business, and in some cases absolutely necessary.

According to one umbrella group it was the medium and larger charities that suffered the highest administrative burden. The smaller charities would be unlikely to carry out the required due diligence, either considering it unnecessary or perhaps adhering to the 'know your' principles in a more informal and less time-consuming manner (discussed later in this section). Larger charities, however, are more likely to allocate resources to meet the requirements of the regulation, which means that volunteers and employees are spending time on this, rather than on other work more directly furthering the cause of the charity:

... more than the cost to the charity, it is the cost in terms of people volunteering their professional services or their experience, so it has cost charities in ways other than money. (Interview 11)

Smaller charities though may have far less financial capacity. A small humanitarian aid charity, for example, may consider the cost of compliance prohibitive and decide not to comply at all. A finance director of a major charity feared for the future of small specialist charities:

If you're a charity that's barely covering your voluntary work, your charitable objectives, if all your staff are voluntary and you're barely solvent, then the risk is that it will put you under, and there are charities in that position... while big charities will certainly be able to bear it and carry on, one does wonder if this is going to strip out the whole infrastructure of smaller charities that do great things in very local, very small, very specialist areas. (Interview 13)

Thus, cost could certainly be a factor influencing compliance with the regulation but may also affect decisions as to where operations are carried out and may for some be a prohibitive factor in the pursuit of their charitable objectives.

2.4 Internal culture and attitudes within charities

Within the participant group there was quite a variation of culture and attitudes to professionalism potentially influencing the regulatory response. Many charities are clearly run efficiently as a business, with clear business plans, targets, well defined roles and a culture of compliance embedded within the organisation. The internal culture within other organisations, however, was not so conducive to compliance.

Compliance with regulatory obligations should be an issue for all and operating within a culture of compliance reinforces accountability.⁹ Within the context of charitable organisations, it is the trustees, employees and volunteers who should be operating within this culture of compliance. For this to be effective, as well as awareness of the regulatory obligations, (which in many cases was

⁹ Deloitte, 'The Changing World of Compliance' (2015) <https://www2.deloitte.com/uk/en/pages/financial-services/articles/the-changing-role-of-compliance.html> accessed 1 March 2020.

found to be lacking) all those working within the organisation need to know what is expected of them in terms of implementation.

With respect to internal culture, supervision plays an important role. Lastra, in her article on judgment-based supervision quotes John Keynes: 'perhaps the most difficult question is how much to decide by rule, and how much to leave to discretion'. This challenge has been highlighted previously with respect to monetary policy. The notion of judgment-based supervision and culture is also advocated by advisors to the banking sector.¹⁰ This could equally apply to the approach to regulation in the charity sector. A culture that is based on judgment focuses on *whether* something should be done.¹¹ The emphasis is placed on the reason for compliance and not on the type of tick box compliance that is often carried out when the reason is misunderstood or is not considered necessary. Several participants revealed that at least some aspects of the due diligence process were considered as such. For example, in the opinion of the CEO of a major charity:

I would think most people are relatively cynical about it, and would see it as an increased level of scrutiny, and don't necessarily see the need for it, but they do it because they have to... (Interview 26)

The internal culture of another major international charity was clearly not one that fostered understanding of the reason for compliance, leading at best to grudging compliance with minimal engagement:

I think there is a feeling that it's something that is not going to be a problem for us and therefore it is more of a tick box exercise, so I wouldn't say there's much engagement -there's almost none at trustee level. At senior leadership level - well other senior leaders have heard about it, and I am pushing the message out to all those that I speak to - but in terms of engagement with it organisationally, there is the sense that of course it is not a risk for us. (Interview 13)

The issue of trust featured very prominently in the culture of faith-based charities in particular, both Muslim and Christian. In some cases, due diligence

¹⁰ Rosa Lastra, 'Defining Forward Looking, Judgment-based Supervision' (2013) Vol 14 Journal of Banking Regulation 221.

¹¹ Deloitte (n 9).

was believed to be to some extent redundant, as trust was very highly valued and was considered sufficient. This belief affected the level of engagement with the regulation. (Interview 13)

Excessive trust within charities was an issue highlighted recently by the Charity Commission in its investigation into fraud. The report did not recommend the introduction of additional policies and procedures, rather it was advocating a change in the culture of the organisation whereby individuals should feel able to speak out if they suspected procedures were not being followed and should not be reluctant to challenge behaviours.¹²

There was no suggestion or indication that there had been any wrongdoing in the examples given by the study participants of the faith charities mentioned above. Nevertheless, within a culture of trust there is surely an enhanced possibility of this happening.

Four of the five participants from major charities stated their opinion that all charities should be run as a business and there should be no exceptions with respect to due diligence. It was their perception that some charities fell short of their obligations in this respect, and there should be greater scrutiny of smaller charities:

... businesses are subject to these types of activities and checks and I think charities should be too- to be honest I think there are a lot of charities who almost hide behind the concept that we are a charity so don't expect us to do the same level of due diligence as you would expect of a business, when actually why not? (Interview 27)

Some went further to say that there were far too many charities operating inefficiently and that measures should be taken to close them down. In other words, entities which were unlike their own, should have to justify their existence. (Interview 26)

¹² Charity Commission, 'Focus on Insider Fraud: Research Report' (26 April 2018).

This was also the view of a regional umbrella body participant (who was also a charity law solicitor and charity trustee) and had dealings with small charities, for example, set up in reaction to the loss of a child. These were often, in his experience, inefficient, ineffective and non-compliant with regulation:

I don't have a great deal of time for those. There are so many who should be merging or operating with a larger charity...I don't think they should be allowed. (Interview 12)

A participant from another umbrella body held a very different view: small charities should be left to pursue their charitable work unimpeded by regulation. The history of many small charities demonstrates that they have stood the test of time, and in some cases hundreds of years, with capital protected by permanent endowment. As an organisational structure, they are a very different entity to either a business or a larger charity, so the same regulation should not apply:

I think small charities should be left alone to get on with what they're doing. They wouldn't have been in business for 300 years. They are protected by permanent endowment, and all the rest of it. If the trustees hadn't been aware, and had good financial procedures in place, they wouldn't have lasted that long. (Interview 11)

The trustee participants of several small charities though felt they could possibly be doing a better job with compliance, however, the amount of time and effort required was an issue. Trustees, usually very involved in the day to day running of a small charity would prioritise more important and immediate matters. With respect to the charitable aims and objectives of the charity, many small charity trustees felt they were doing a good job under difficult circumstances to ensure that these were met. There was often a very personal connection with the charity, to which the emotional investment as well as their time commitment was very significant. (Interview 19 and 22)

The internal culture of the organisation appeared to influence attitudes to compliance within the participant group. There was a firm belief amongst the larger charities that compliance failings were more likely to occur in smaller

entities, and that this should not be tolerated. However, non-compliance was not just an issue of size. Lack of engagement and understanding of regulatory matters or excessive trust within the organisation were also factors that affected compliance and could be attributed to the internal culture and leadership.

2.5 Formal/informal compliance procedures

Compliance may be taking place on an informal basis. This is much more prevalent in small charities where trustees may have several roles within the charity, and operations may be on a small scale. There is no legal requirement for charities to have a risk management strategy in place and to have formal compliance procedures. Some smaller charities do not see this as a necessary.

I don't do a risk assessment as such because I know everybody who is involved; I know them personally and I don't think the people working in this charity are people I need to worry about, there is obviously a lot of trust involved. (Interview 22)

Other charities carry out due diligence on an informal basis: satisfied the 'know your' principles are adequately met due to their personal relationships along the chain from donor to recipient:

...they do appeals and distribute resources, they will have family connections, or they will have religious connections which will enable them to know the end source, the end beneficiary and to monitor that flow. Again when you base it on these kinds of personal relationships there are risks of course, but actually there are also benefits, because it's that knowing your own customer is the best way to know them- is to physically know them, have a long-standing relationship with that individual and know what they do, and how they operate, and where the activities are carried out... (Interview 4)

Many of the larger charities reported having formal compliance procedures in place, having the professional expertise and the financial means to do this.

I would say we were one of the early adopters to any of the legislation and to be honest we have gone a little bit overkill on our internal requirements. (Interview 7)

However, this would be unrealistic and unnecessary for all charities. There comes a point though when informal channels are no longer adequate, and this may happen when a charity is of a sufficient size for individuals to have distinct and separate roles with fewer channels of communication, and in some cases the trustees not having sufficient control over the management. This was evident in several of the medium and large charities where trustees had delegated some of their powers, but there was a lack of oversight and monitoring of procedures in a way that would not happen in the major charities with more formalised compliance procedures:

I think it's more likely to be the middle-sized charities that don't have those resources; I don't think the trustees would think about it. I think it would be reliant on somebody within the employee team to review that, and I suspect they think that's another thing to add to my list and I've got to go and sort out health and safety and all the other things... and I suspect if they can get away with not doing very much, not deliberately, but I don't think it would be a priority. (Interview 12)

There appears to be a perception amongst major charities within the participant group, as noted above, and more widely within the charity population, that these charities have the means and motivation to be compliant, and as such are beyond reproach. This perception has been challenged recently, for example in the current revelations from Oxfam “where worthwhile safeguarding measures have been developed, they have never been adequately funded” leading to what MPs have described in a recent report on the issue as a ‘safeguarding deficit’.¹³

Compliance procedures may therefore be formalised within the organisation. Equally informal due diligence may adequately fulfil compliance requirements, but it requires the organisation to consider whether they are in fact effectively safeguarding their organisation.

2.6 Risk assessment and management

The internal culture of the organisation and approach to risk could also be on a spectrum between formal and informal. An unduly formal approach to risk

¹³ International Development Committee, ‘Sexual Exploitation and Abuse in the Aid Sector’ (Report, 31 July 2018).

could ultimately affect the ability of the organisation to innovate. However, an unduly informal approach could mean that employees are not aware of what needs to be considered in their own decision-making with regard to risk.¹⁴ Amongst those who were aware of the risk to the sector, there was very little evidence of a meaningful assessment of the risk either informally or on a more structured basis within their organisation, particularly amongst the smaller charities.

Many of the participants in medium-sized and even large charities had not assessed the risk of terrorist financing within the charity. Risk management generally did not appear to be a priority for many, with the exception of the major charities. There was no evidence in many cases that risk management policies were routinely communicated internally, and trustees, having delegated responsibility for this, were subsequently unaware of the outcome of the discussions (as was the case with compliance procedures).

The capacity for risk-taking is an important aspect of strategic decision-making. However, at operational level controlling the risk is also imperative. The 2011 PKF accountants' survey reported that only 28% of respondent charities had considered their risk management to be embedded in the organisation and operating effectively.¹⁵

The 2012 charity risk survey undertaken by accountants PKF, and the CFDG concluded that 30% of respondents had no risk policy in place, and 41% had no plan in place should a risk materialise which exceeded their risk tolerance.¹⁶ A further survey identified both cost and time as major barriers to confronting risk. Reputational impact of associates was among the factors accorded low significance amongst participants, signalling either confidence in their partners, or that little consideration had been given to this potential risk.¹⁷

¹⁴ Kingston Smith, 'A Toolkit for Effective Risk Management' (2013).

<https://www.kingston-smith.co.uk/insights/charities-risk-toolkit/> accessed 1 March 2020.

¹⁵ PKF/CFDG, 'Managing Risk: Operating in the New World' 2011 12.

¹⁶ Kingston Smith (n 14) 1.

¹⁷ Zurich, 'Charity Risk Survey: Attitudes and Approaches to Risk in the Voluntary Sector' (2015).

The Institute of Risk Management report, published in 2017, highlighted the importance of a culture within the organisation of positive risk management, to enable people throughout the organisation to raise concerns about risk and become involved in the management of uncertainty.¹⁸

In the present study, it was evident that risk management was neither embedded in the culture of the organisation nor was it accorded much importance for many. However, a statement of risk to the effect that due consideration has been given and steps taken to manage the risk, is now a legal requirement for charities that are required to have their accounts audited.¹⁹ For incorporated charities, as a minimum, a note in the company's board minutes should be made, and for unincorporated charities a minute should be produced and held on file of the relevant factors considered and conclusions reached.

Although trustees have overall responsibility for the management of risk, this can be delegated, as with other powers mentioned previously, to sub-committees or a senior management team. A participant in a major international charity with humanitarian projects, explained that all risks were assessed, and robust internal controls were in place, which were periodically monitored (including the risk of bribery) thus demonstrating particularly good practice:

... it's very much the case that all the various departments, all divisions that feed into the programme side, that they are expected to do their own risk analysis. Those risk analyses I put on their risk register and the risk register is formerly overseen by internal auditors, who then report up to the audit committee. So, it's taken up to the highest level. Within the audit committee will sit internal specialists as well as trustees, and external personnel as well. (Interview 7)

Bribery risk should also feature in the overall risk management process for charities operating in areas where bribery and corruption are known to be prevalent and consideration given to the provisions of the Bribery Act 2010, as

¹⁸ The Institute of Risk Management, 'Risk Governance for Charities' (2017).

¹⁹ Charities (Accounts and Reports) Regulations 2008, SI 2008/629.

well as local legal requirements. The risks should be assessed, and the relevant procedures put in place. Effective communication of the policies, both within the organisation and externally, is also necessary to ensure employees and partners are aware of the risks, how they should respond, and the consequences of being found to have made or received a bribe.²⁰

Again, many of the participants, both trustees and managers, were unaware of bribery risk and noted an absence of policies, or low awareness of anti-bribery policies within their charity in geographical areas in which this is more prevalent. (e.g. Interviews 14 and 16)

Another participant from an international charity considered that the requirement to pay money for safe passage of goods or to provide services could be construed as bribery as an alternative to terrorist financing if the recipient could not be identified as a terrorist. In either case a criminal offence could be committed:

Charities have to be very wary of making payments, and always consider this could be illegal, whether it is bribing an official or handing money over to terrorists. I am sure in some instances this could happen. (Interview 27)

The Humanitarian Policy Group found marked differences in acceptable risks to charities when dealing with proscribed organisations such as Hamas; reporting that one accepted that contact was necessary for the delivery of humanitarian assistance, whereas another would not deal with them at all, as the risk of their action being construed as illegal was deemed too high.²¹

Many charities with a humanitarian purpose face a dilemma with respect to distribution of aid, and whether it is morally acceptable to withhold aid, for example to suspected terrorists, or those who may be supporting them. Making exhaustive enquiries in order to be absolutely sure whom they are dealing with

²⁰ BOND, 'Anti-bribery Principles and Guidance for NGOs' (June 2011).

²¹ Sara Pantuliano and others, 'Humanitarian Policy Brief 43: Counter-terrorism and Humanitarian Action: Tensions, Impact and Ways Forward' (HPG October 2011).

may be impractical in situations of desperate need. Individuals on the ground may decide this risk has to be taken, and this may also be within the risk appetite of the charity and supported by the internal culture.

On a moral level you can have some sympathy with that. Obviously, that's not how the government or regulator would see it. If you're on those lists or you are a sanctioned individual or part of a sanctioned entity you should be persona non grata ... How much can you know when you are working in an environment which is so fragile where records might not be possible? (Umbrella body-Interview 4)

Risk assessment and management was thus given scant regard by many of the participants, which potentially leaves the organisation in a vulnerable position. If no consideration is given to risk, then clearly no steps would be taken to mitigate risk. Furthermore, the failure to assess risk and keep adequate records confirming risk had been contemplated could constitute a breach of legal requirements.

2.7 The use of technology

Although the availability of technology may be considered an external factor, its use by individual charities and the influence it has had on their response to the regulation will be considered here.

As huge advances have been made in technology, charities may see this as an opportunity to improve and streamline their response to the regulation. From carrying out checks on the provenance of donations as part of due diligence processes, to using automated terrorist financing screening services such as the system provided by Thompson Reuter, and other means available to automate compliance with the regulation. The regular use of screening software amongst the study participants in general was found to be low. One major charity though with a domestic focus, reported screening staff and volunteers and using a sophisticated system for fraud detection in numerous charity shops, being mindful also of the possibility of diversion of funds for terrorist purposes. (Interview 26)

A further example of use of screening software throughout the organisation was provided by a major international charity with a humanitarian focus. All third-party partners and beneficiaries were routinely screened using screening software, as well as all their employees, their suppliers both in the UK and overseas and their volunteers and trustees. (Interview 7)

Another benefit from using automated software came from the sharing of information between charities, which could assist in decision-making. A participant from a national umbrella body noted that this was something that charities were doing routinely, often on an informal basis. Those responsible for carrying out checks within the organisation, for example, may contact other organisations with a similar mission, or perhaps operating in the same geographical area, and alert them of information that may assist them in their own decision-making around risk:

... much more they're using things like World-Check... they are sharing information between themselves as charities to identify risk; risky partners and risky areas" (Umbrella body - Interview 4)

With respect to financial services, many of the smaller charities felt constrained by the lack of opportunity offered to them to use more streamlined services, and lack of cooperation from their banks. Although this will be discussed more fully in Chapter Seven, the level of automation within the banking services that were offered to them in some cases affected their ability to account affectively for the funds, and this was reported to be time consuming:

We have a lot of people who pay membership fees by standing order because we can't do direct debits- we're not allowed to, which is a nightmare particularly when we change the membership rates, but we have issues with standing orders going missing and trying to deal with the bank is a nightmare. (Interview 19)

Blockchain technology has the potential to revolutionise the method in which funds are transferred, which could be of great benefit to charities in the transfer of funds from donor to charity or in the onward transfer of funds to the eventual beneficiaries. Blockchain technology, the emerging technology which underpins

digital currencies, has also been described as a 'distributed ledger system', with each 'block' of information connected to other blocks by means of complex computer algorithms and stored in multiple locations, rather than centrally. For this reason, it is more difficult to hack into than would be the case in a more centralised system, as information exists simultaneously in multiple locations and information is constantly reconciled into the database. There is also the advantage of increased transparency in that many ledgers are publicly available to those who have the knowledge to access them.²²

There was very little awareness and understanding of blockchain technology amongst the participants, which is unsurprising as its use in the charity sector is in its infancy. The London-based St Mungo's charity for the homeless is pioneering the technology as a transparent fund-raising tool.²³

One participant from an umbrella body was very enthusiastic however about its potential use in the transfer of funds:

...technology such as using the blockchain or other forms of information which would create greater transparency- so you know with the blockchain you might be able to deposit money in the UK and then that would create a kind of digital record which would follow that money, that pound wherever it went. When it went to Syria, they could see who is accessing it... (Interview 4)

It is envisaged that this emerging technology could not only revolutionise the way in which funds are transferred, automate governance, regulation and funding agreements in the sector, but also affect the manner in which business is conducted more generally.²⁴ This could potentially also increase compliance with regulation and change the role of the regulator, which will be discussed in greater depth in Chapter Eight.

²² Kirsty Weakley, 'What Charities Need to Know About Blockchain (and what they don't)' (Civil Society Voices 16 January 2018) <https://www.civilsociety.co.uk/voices/blockchain-what-charities-really-need-to-know-and-what-they-don-t.html> accessed 1 March 2020.

²³ Kirsty Weakley, 'St Mungo's uses blockchain to be transparent about donations' (Civil Society 12 May 2017) <https://www.civilsociety.co.uk/news/st-mungo-s-uses-blockchain-to-be-transparent-about-donations.html> accessed 1 March 2020.

²⁴ Weakley (22).

The use of technology therefore has the potential to assist in compliance with regulation and to increase the transparency of transactions, which could increase confidence that monies are being transferred to the intended end user. This could have a more wide-ranging positive effect on the reputation of the charity sector. The use of technology however has cost implications, for example screening software: beyond the reach of charities with limited resources.

2.8 Time since the formation of the charity

The age of a charity may have an influence on the response to the regulation. Newly formed charities, for example, may have less sophisticated processes in place, even if operating in high-risk areas. If a charity has a short-term focus it may also be prepared to take greater risks. Many new charities were established in response to the crisis in Syria; around 200 registered in the first three years since the start of the crisis. There has been doubt cast on whether they all have the knowledge, ability and experience to enable them to operate within the regulatory framework.²⁵ Diversion of funds has been seen as a potential problem area as donors respond generously to emergency appeals. The Charity Commission, recognising that entities purporting to be charities could solicit donations from unsuspecting members of the public, issued guidance in this regard, urging donors to make checks before donating.²⁶

Many of the participants interviewed mentioned reputational risk when discussing compliance, and this was a major factor especially with the large well-established charities, for whom the ability to assure donors of compliance with regulation was a priority. The potential difference in response from a newly established charity, and one that is more mature may therefore be significant.

²⁵ Tom Keatinge, 'Uncharitable Behaviour' (Demos 2014) 84.

²⁶ Charity Commission, 'Support Syria Safely' Information Leaflet https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/372893/syria-safer-giving-english-leaflet.pdf accessed 1 March 2020.

3. THE ANALYTICAL FRAMEWORK

The complexity of the legal landscape to which charities are required to respond has been discussed previously.²⁷ Within this current chapter a framework for analysis is proposed in order to contextualise the responses and comments from the participant organisations within the legal landscape. A framework for analysis could be based using a selection from several possible factors in order to frame the participant responses; size of organisation, focus of charitable work (their mission), operational geographical region, previous history of regulatory compliance etc. For this particular study, and as a first level of analysis of how the participant organisations engage with the regulation, the two factors of ‘awareness of the regulation’ and ‘responsiveness to the regulation’ have been selected.

For the purpose of this analysis ‘awareness of regulation’ has been based on how, qualitatively, the participant organisations commented on factors such as the depth and specificity of understanding of the details of the regulation and the unprompted referencing of regulatory awareness as an organisational rather than individual understanding.

Similarly, participants commented on varying levels of ‘responsiveness to the regulation’. Interviewees may, for example, have commented on specific organisational processes (e.g. risk assessment, internal audit etc.) or discussed various organisational roles (e.g. compliance officer, risk officer etc.), which could demonstrate an organisational response to the regulatory framework.

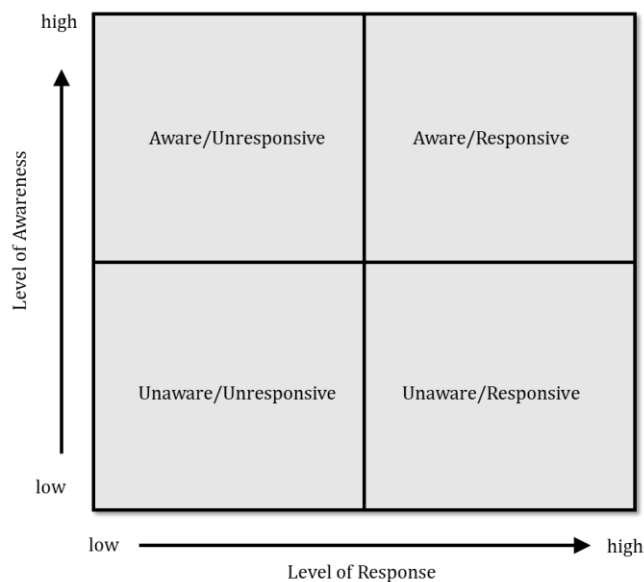
Additionally, in both the analytical framing dimensions of ‘awareness of the regulation’ and ‘responsiveness to the regulation’ the comments from the interviews have been qualitatively reviewed to understand the feedback as having organisational or individual scope i.e. whether the interviewee was

²⁷ Chapter 3: Chapter 4 s.4-5.

making the comment on behalf of the organisation overall or as an indication of an individual perspective.

With two axes of 'awareness of the regulation' and 'responsiveness to the regulation' the comments from the participant organisations can be framed into four specific groupings as illustrated in the diagram below. Comments from the interviews have been analysed with reference to these specific groups and the results are presented in later sections of this chapter. In the case where more than one participant from the same charity was interviewed individually, the level of awareness of the regulation may have been different. For example, the responses from the 'director of finance', or from the 'executive director', the perspective may have differed, but in reality, this was not to the extent that any conflict arose in the categorisation of the charity into one of the four 'ideal types' within the framework. (Interviews 14 and 15)

Figure 6.1



4. ANALYSIS OF THE DATA

4.1 Unaware/Unresponsive

The charities fitting into this category can be characterised by low awareness of the requirements of the regulation. This may also be accompanied by low awareness of the underlying challenges, which the regulation is intended to address. The concept of awareness can be characterised by observations and comments from the primary research interviews, when interviewees have demonstrated a lack of awareness and understanding of the regulatory framework. This has been ascertained either by the interviewee proactively introducing such concepts when responding to questions in an unprompted manner or alternatively, this has become apparent when interviewees were directly asked about their understanding of the regulatory framework and the likely impact on their organisation.

In terms of unresponsiveness, this category of organisation, due to their lack of awareness of the regulatory frameworks are de facto unable to respond. Both of these dimensions however are continuums and so there will be degrees of awareness and responsiveness in each if the groupings within this particular framework approach. At this introductory stage however, the focus will be on describing each group as a discrete area for the purpose of clarity and also for the purpose of providing a lens by which the interview responses can be interpreted and classified.

Several of the interview participants and their organisations can be classified into this unaware/unresponsive group. Factors indicating this categorisation could include:

- At the interview set-up stage, the interviewee signalled a lack of awareness/understanding of the regulatory framework.
- During the interview itself, the interviewee displayed an apparent lack of understanding of the regulation.

- The interviewee would seek explanation and/or clarification of the regulation from the interviewer prior to responding.
- There were no apparent mechanisms such as informal/formal processes to enable the organisation to respond to the regulatory requirements.
- There was an absence of clear roles and responsibilities in terms of who in the organisation was accountable for regulatory compliance in this context.
- There was a seemingly low level of cultural compliance with respect to this particular regulatory framework.

Many of the participants were completely unaware of the risk to the sector in general of abuse for the purpose of financing terrorism. They clearly would not therefore make an assessment of the risk within their individual organisation.

For several charities the risk of their organisation being used as a conduit for terrorist financing was one that they had not even contemplated. A participant representing a regional charity umbrella body commented that, with respect to the member organisations, but particularly small and medium sized charities:

My concern would be, I don't think it would even cross their minds that there could be a potential problem in something like money laundering or use of funds for terrorist activities or something like that- I don't think they would ever think about that. Unless there is somebody who had gone on the training course and it has been brought to their attention. (Interview 12)

This view was also confirmed in the interviews with participants from some charities; with reference to the requirements of the regulation and risk assessment for financial crime generally:

I don't think a trustee of a charity, unless it's one of the very big ones would even know what you're talking about. (Trustee- Interview 2)

With respect to due diligence in general, many charities in this group had no or very few processes in place to record where their donations came from. These charities reported receiving direct debits from regular donors, and regular

anonymous donations as well as bequests, with others receiving large amounts in cash donations. All mentioned that they made little enquiry as to where the funds came from. An example from a regional charity providing training to other organisations within the sector:

If somebody leaves some money and says I just like what you're doing so here's a cheque for £20,000 or something, and then possibly tries to influence what they're doing with it, I don't think it would ever even cross their minds. (Interview 11)

Another regional umbrella group was particularly concerned at the low level of awareness of the need for due diligence with respect to the source of funds, and the potential problems with large unidentified donations and ensuring that this does not derive from an illegal source or one which could possibly be in conflict with the values of the charity:

It might be different when you have charities that are predominantly working abroad, where either their beneficiaries or their sources of funds will come from abroad. They are probably more aware of potential issues, but your average trustee of a charity over here, unless it was something that looks so obviously peculiar, I don't think they would ever query it. (Interview 12)

A participant from a national umbrella group was concerned that the 'know your' principles regarding beneficiaries were given scant regard, in situations where processes should have been in place to comply with this aspect of the regulation:

... a very low awareness of the ability and need for charities, particularly if they're working overseas in sanctioned countries to vet their beneficiaries. (Interview 4)

This lack of awareness of due diligence requirements was also reported by charities themselves, for example a trustee from a small charity:

I know there is a lot of regulation that we are supposed to comply with. I wasn't even aware that we were supposed to do a risk assessment or any of this due diligence you're talking about. (Interview 19)

Amongst some Umbrella groups and those advising charities, there is concern about aid convoys and the risk they pose. The concern extends to some charities

supporting aid convoys, which are doing so completely unaware of the risks involved to the charity, and oblivious to the regulatory framework.

...this idea of community convoys that go out to Syria, now they are in the community space and some are sponsored by the charities and supported by the charities or mosques or other religious institutions... but they are not part of that regulated community so it's hard to make any general assertions about that, clearly they are not in the formal sector so the risks are probably higher...(Interview 4)

Even though these groups may not be set up as a charity, the donated funds/goods would be considered as charitable assets by the Charity Commission should there be any inquiry into the end distribution. If for example the goods ended up in the hands of terrorists, this would undoubtedly cause reputational damage to the sponsoring charity concerned, and trustees could potentially be criminally responsible under the Terrorism Act 2000.

There was a perception among participants in the larger charities in particular, and some smaller regional umbrella bodies, that the problem of lack of awareness stemmed from the trustees not understanding the full extent of their responsibilities. Several of the participants in the charities under review themselves admitted that they 'didn't know what they didn't know'.

The charities categorised within this group, agreeing to take part were micro-medium organisations in size, and had a focus or mission that was limited geographically. None had subscribed to umbrella organisations although one was an independent body with affiliations to a national organisation.

Although the number of participants fitting into this category was small, many of the umbrella groups and participants from larger charities described charities either within their membership, or of their acquaintance, as being unaware and unresponsive. The comments from larger charities though may emanate from a position of prejudice, be completely unfounded or based on inaccurate information as many considered themselves superior. With reference to the factors that could indicate the categorisation, outlined at the

beginning of this section, many charities that either met the initial criteria, or were likely to do so, were approached and subsequently declined to participate. In the initial stages the potential participant may have felt they had nothing to offer, having read the participant information sheet, and some had admitted to the researcher that they had no awareness or understanding of the regulation and would therefore not feel comfortable taking part.

The impact of implementation of the legal requirements

Charities in the unaware/unresponsive arena were clearly not expending resources specifically on compliance, however this does not mean that they were non-compliant. Charities are required to assess the risk and act accordingly.

Many charities may be doing this on an informal basis, as discussed earlier, which may be the case for a small charity with well-established income streams and a limited beneficiary pool. Many charities had not formally assessed the risk of financial crime; the risk of terrorist financing is very low in most charities, but other risks such as tax evasion, money laundering and fraudulent activity within charities are also possibilities. Some were at least aware of the overall risk of financial crime, whereas others were unaware of any risk to their charity or felt that the risk of any financial crime was so minimal as to warrant no discussion amongst the trustees. The trustees should at least be having a discussion around risk at board level and noting this in the minutes as a matter of good governance.

4.2 Unaware/Responsive

Organisations who may be grouped into the unaware/responsive category are characterised by a high concern for compliance, but a lack of awareness of the detailed requirements of the regulation. The organisational response is therefore unfocused and lacks completeness and effectiveness in terms of the regulation.

This may be an unusual categorisation to consider, but since this research involved discussions with trustees who themselves have legal obligations in terms of organisational compliance, it is unsurprising to find individuals or organisations demonstrating a concern for compliance in the broadest sense of the term, but lacking up-to-date knowledge of regulation or the impact this could have on them as individuals or organisations.

The concern for compliance may be driven by many potential factors such as the charity's position as an organisation in higher profile sectors, or previous penalties for breaches in compliance. The key differentiator for organisations in this category is the clear commitment to regulatory compliance, but a distinct lack of understanding of either a) what compliance includes in terms of scope, procedures etc. or b) how to implement compliance in terms of processes/approaches within the organisation.

Some of the initial indicators of organisations who could potentially be classified as unaware/responsive could include:

- An interviewee very willing to take part in the interview process and to use this as an opportunity to gather the most up-to-date understanding of the regulation as part of this discussion.
- During the interview itself, probing on the part of the interviewee into what the regulation specifically entails, as well as how other organisations have responded to be compliant.
- There would be clear mechanisms for intended compliance, but these may not necessarily be focused on the most appropriate aspects of the regulatory requirement.
- Potentially a level of frustration could be displayed with the incomprehensibility of the regulation.
- No apparent mechanisms such as informal/formal processes to enable the organisation to respond to these regulatory requirements.
- An absence of clear roles and responsibilities in terms of who was accountable for regulatory compliance, and a seemingly low level of

cultural compliance with respect to this particular regulatory framework.

- There were due diligence measures and a culture of compliance with other regulation embedded in the organisation.

Several charities had noted an atmosphere of increased scrutiny within the sector, which was causing some anxiety, and their response was to familiarise themselves with existing regulation. In some cases, they were unsure what this meant for them, and how to respond, and would have liked some guidance in this respect:

There's been a lot of change within the sector general... as far as the recent examples such as Oxfam and other major charities, there is certainly more unofficial scrutiny, or a sense of scrutiny... there has been reference to the increased scrutiny of charities by our central office-so it's something that charities are more aware of. Not that there's anything in writing at the moment, and not that any laws have changed. (Interview 23)

The same charity had experienced conflict with an affiliated body, which had been explained to the researcher, and had certainly caused them to react to any regulatory requirements with a level of nervousness, which may not have previously been felt. This caused them to respond to regulation in an over-zealous manner in order to cover themselves, which may not have been the most appropriate response, and noted the challenges in attempting to comply with regulation in the absence of any support. During the interview the participant requested information about compliance mechanisms and discussed due diligence, together with possible sources of information and guidance. (Interview 23)

In some cases, other regulatory bodies were also relied upon to have made the necessary checks, but that reliance may be misplaced:

There is already the FCA making sure that they are not involved in something terrorist or anything like that, so I think we are implicitly assuming that the due diligence has been carried out. (Interview 16)

In another large charity, a trustee was confident that compliance with regulation was a priority, and there were generally systems in place, but regarding this regulation was unsure of the position, and was unsure where the responsibility for this would lie. (Interview 5)

Very few of the participant trustees of small-medium charities had a clear understanding of the risk management process adopted, within the organisation, if indeed there was one.

We have a finance risk and governance subcommittee, the responsibilities for risk and governance issues lie with them ... Risks are rated, and they focus on what could go wrong, though I'm not sure whether there is anything in place after that. We need to be aware of what to look out for. (Interview 18)

Even some larger charities operating in developing countries were not conducting a formal risk assessment, and seemed unsure of what was required, with no apparent mechanisms to enable the organisation to respond:

I wouldn't go as far as to say we had made a risk assessment ... I suspect we are doing it without consciously realising; without having policies around it. (Interview 16)

The organisations categorised within this group were of all sizes except major and micro: large enough to appreciate the need and consider that they should have at least some due diligence measures embedded in the organisation. However, they were either insufficiently mature as an organisation, or lacked the necessary expertise to translate the risk of financial crime into effective policies which were understood by both trustees and employees within a culture of compliance.

The Impact of implementation of the legal requirements

Those in the unaware/responsive category were unclear as to what they were responding to. These were more likely to be larger charities than the previous group and, in some cases, a disconnect between the vision of the trustees and the operation of the charity. One of the dominant factors, and a barrier to

implementation, appears to be a problem in accessing information and guidance, including that provided by the Charity Commission (discussed further in Chapter Eight). The general level of regulation was considered burdensome amongst this group, with many citing the recently introduced General Data Protection Regulation (GDPR) and other regulation imposed on charities across the board having a disproportionate effect on them. They were conscious of the need to comply but did not have the same financial resources or expertise at the disposal of larger charities.

...the effects on the population of charities is so damaging and it must be so frustrating to be a trustee of a small charity because of all these measures imposed on them they can hardly breathe now for somebody saying, "don't do that!" ... (Interview 11)

Some of the charities were members of umbrella bodies, but these tended to be mission specific; and issues relating to governance and regulation did not come under their remit. Although aware of the existence of a wide range of umbrella bodies, participants reported that engagement with these was limited, either due to membership fees, lack of understanding of the benefits and confused messaging. Participants were looking for individual bespoke advice, which in the main was not forthcoming.

Accountants were frequently cited as a source of external advice for trustees in this group, though the issue of cost again arose. The accountant would be expected to alert them to any issues that needed further consideration and trustees generally drew comfort from the fact that an expert eye was being cast. Professionals were usually drawn from local firms rather than specialist charity accountants. (Interviews 5, 16 and 18)

4.3 Aware/Unresponsive

Organisations who may be grouped into the aware/unresponsive category are characterised by a high awareness of the requirements of the regulation. They may also have an extensive awareness of the underlying challenges, which the regulation is intended to address. This awareness of the regulatory

requirements may not necessarily be matched with an understanding of the impact the regulation may have on their organisation, or of the impact that non-compliance to the regulation may have on their operation or ongoing sustainability.

In contrast to the unaware/unresponsive cluster, this category of organisations does have awareness of the regulation and therefore make a conscious or unconscious choice to be unresponsive. This unresponsiveness may be, for example, due to a lack of experience in implementing such regulatory compliance procedures, or due to a lack of appreciation of the consequences of regulatory non-compliance.

Several organisations that could be classified as aware/unresponsive were identified, and this formed the largest group. Factors indicating such categorisation could include:

- At the interview set-up stage, the interviewee, either during telephone conversations or email correspondence, signalled an understanding of the regulatory framework and, compared with the first group, showed a greater willingness to engage with the subject matter of the interview.
- During the interview there was some hesitation and even reluctance to discuss the organisational responses to the regulatory framework.
- The interviewee displayed an apparent lack of understanding of the impact of non-compliance to the regulation.
- Once again there were no apparent mechanisms such as informal/formal processes to enable the organisation to respond to the regulatory requirements.
- Similarly, there was an absence of clear roles and responsibilities in terms of accountable for regulatory compliance in this context.
- Even though the organisation displayed awareness of the regulation there was a low level of understanding or commitment to how the organisation could respond to achieve compliance.

Participants would typically be enthusiastic in sharing their understanding of the underlying problem of terrorist financing within charities and sharing their experiences of the regulation. For this group, they had heard the message but were not necessarily putting it into practice.

The charities in this group of aware/unresponsive were more likely to be medium to large in size, and less likely to be members of national umbrella bodies. A faith mission guided the charities in this group (with one exception), and the participants placed greater emphasis on relationships with people and organisations with shared values.

A participant trustee from a major charity, whilst demonstrating responsiveness within their charity, held the view that many charities that she had previously been involved with did not respond to the regulation, despite being aware of the requirements, and this was a question of attitude:

I think there are a lot of charities who almost hide behind the concept that we are a charity so don't expect us to do the same level of due diligence as you would expect of a business. (Interview 27)

Similarly, one participant was well aware of the requirement to account for donations and the possibility that further enquiries may be necessary, but with no apparent mechanisms in place and no one apparently responsible for a compliance role despite being a medium-sized charity:

Cheques would come through the door for £5,000 and there was no policy in place to say at what level we needed to do a due diligence check on unsolicited donations, and in all honesty the extent of the policies and procedures we need are not yet in place either. (Interview 24)

The question of anonymous donations and the obligation of zakat also arose in the context of Muslim charities. The dilemma may arise if there was conflict between the religious requirement for anonymous giving and the obligation for transparency and visibility of financial flows required by the CTF regulation.²⁸

²⁸ Discussed in Chapter Two 3.2.2 B.

“...you should give something that your other hand should not take, so you are not boosting your own image or position in society... Although potentially there could be tensions, I think in the UK people understand. It may not be the same in other countries though. (Interview 6)

This does suggest that at least individual donors may be aware of the requirement for transparency and this does not cause tension between what could amount to conflicting obligations.

Sanctions could also be of concern to this group, with some scepticism about their practical utility, and the potential for designated persons to circumvent scrutiny:

... because of some activity in their country, but the irony is they're not going to come to us and give us their real name: they will give us aliases. (Interview 21)

It is incumbent upon organisations to carry out the necessary checks to ensure they are not dealing with terrorists, contrary to domestic legislation or that in place in the countries in which they operate. However, as there is no universally accepted definition of terrorism, this could be problematic on a practical level, as discussed in Chapter Three (section 5.2.1):

You can't always know who the terrorists are. There are all these lists. It can be very complicated and costly and time consuming if you have to check everybody. If you are giving humanitarian aid of course you wouldn't want to support terrorism, but we can't always decide who is a terrorist- even different countries can't agree on that. (Interview 15)

Risk management could also be problematic. Some charities with policies embedded within the organisation in relation to other risks, for example safeguarding of vulnerable children, were not carrying out a risk assessment in relation to financial crime. Given their specific circumstances this may have been a useful exercise, possibly leading to the conclusion that further compliance measures were required:

We do do risk assessments on all sorts of different features, but not on terrorist finance risk in particular. The need for risk assessments has been flagged up, in that we do send funds to our international organisations. (Interview 14)

Another charity was aware that due diligence was required with respect to donors, beneficiaries and partners but had failed to carry out the necessary level of due diligence on other individuals with whom they were working alongside, in a timely manner. At the time the UK based charity had taken the close working relationship as a matter of trust and had not considered it necessary to carry out checks.

An inter-faith group was involved in taking donations to Calais a couple of years ago and working alongside a Muslim charity until it found out it had links with an organisation designated by the US as a terrorist organisation. (Umbrella body- Interview 12)

The matter of trust featured prominently in the discussions with participants in this group. One finance director of a large charity operating overseas was aware of the due diligence requirements, but trust was considered sufficient, and commented:

Obviously, this does not always meet the same bar as legal due diligence...because we work through the church and other church groups there is this kind of perception that it is unlikely to be an issue for us, so we shouldn't need to invest in this. (Interview 13)

Another faith charity participant was similarly trusting of partner agencies and colleagues:

I don't do a risk assessment as such because I know everybody who is involved; I know them personally and I don't think the people working in this charity will be people I need to worry about, there is obviously a lot of trust involved. (Interview 22)

Charities may be well aware of the need to ensure that they are not inadvertently supporting terrorists, for example, in the distribution of humanitarian aid. However, there are practical difficulties, as highlighted by one umbrella organisation:

How much can you know when you are working in an environment, which is so fragile, where records might not be possible? ... (Interview 4)

Furthermore, there were concerns that in conducting due diligence, and consequently holding information on partners, beneficiaries and employees, a security risk may arise:

... say in Gaza, the charity was distributing aid to people, there is concern that, what if Hamas breaks the door down and steals your information and uses those lists to target people?All your employees' records are at stake; you may not want to hold information that would put your beneficiaries or employees at risk... (Interview 4)

Although this may cause a dilemma, the charity may decide that the security of the persons involved outweighed any potential criticism that may accrue. If the Charity Commission were to investigate, for example allegations of wrongdoing, it is conceivable that this lack of written record would be accepted in the circumstances outlined in the example above.

In comparison, the United States Agency for International Development (USAID) goes much further in requiring, through its Partner Vetting Scheme (PVS), the collection of personal data of officials and employees associated with US-funded aid projects. USAID, which piloted the scheme in Gaza and subsequently expanded to other areas where known terrorist groups operate, defend the scheme as being compliant with their obligations with respect to the counter-terrorist financing legal framework.²⁹

Others have reported that the lives of aid workers are being risked as the data collection, shared with the US Government, may be viewed as providing intelligence, and consequently the individuals concerned may be accused of spying.³⁰ This has also prompted aid groups to distance themselves from USAID-funded projects. Mercy Corps for example withdrew programs in Afghanistan and Ukraine fearing that compliance with the PVS requirements

²⁹ Scott Amey, 'USAID's Partner Vetting System: Controversial but Necessary' (Blog, Project on Government Oversight 3 July 2015) [http://www.pogo.org/blog/2015/07/usaid-partner-
vetting-system.html](http://www.pogo.org/blog/2015/07/usaid-partner-vetting-system.html) accessed 1 March 2020.

³⁰ Ron Nixon, 'US Screening on Foreign Projects Roils Aid groups' *New York Times* (New York, 7 December 2015) [http://www.nytimes.com/2015/07/12/us/politics/us-screening-on-foreign-
projects-roils-aid-groups.html? r=0](http://www.nytimes.com/2015/07/12/us/politics/us-screening-on-foreign-projects-roils-aid-groups.html? r=0) accessed 1 March 2020.

would undermine the trust of the local communities and endanger lives.³¹ Critics also point to the lack of evidence that US state aid is diverted to terrorist groups. There is also no evidence that recipients of grants have actually been denied funding as a consequence of intelligence-gathering through the PVS scheme.³² This therefore suggests that the scheme is aiming to address a problem that has been grossly exaggerated.

The risks associated with cash transactions have been previously highlighted.³³ Most charities were aware of the enhanced risks when dealing in cash in unstable areas, that this may get into the wrong hands and be used to fund terrorism or be involved in corrupt activity, and the inherent difficulties with respect to providing an audit trail. Nevertheless, several considered the benefit outweighed the risk. One faith charity had raised thousands of pounds for refugees and was sending the cash out with a cleric who was visiting a refugee camp. (Interview 6)

Some humanitarian charities face a dilemma when distributing humanitarian aid with respect to their adherence to the spirit, as well as the letter of the sanction regime, and fulfilling their charitable purpose:

...at the extreme end, but there are certainly some charities who I'm sure say look it doesn't matter whether a person has been a terrorist in the past and they are starving to death it's our job to give them food. (Interview 4)

A participant from an umbrella body supporting charities of all sizes and missions was of the opinion that most charities were aware of the risks they faced of financial crime, although neither the Regulator nor policy makers always recognised this. The challenge however related to the degree of compliance shown by the charities, and possibly the selection of which elements of the regulation would be complied with and which could be ignored:

³¹ *ibid.*

³² Jude Howell and Jeremy Lind, *Counter-terrorism, Aid and Civil Society before and After the War on Terror* (Palgrave Macmillan 2009) ch 8.

³³ Chapter Three s 5.4.

Unfairly some regulators and the government have the view that charities are just going out there blissfully unaware that there might be Isis out there ...that there are no criminals in the UK and that charities are just operating the very naive way of assuming that everything will be fine; they don't do that... there might be, yes terrorists or others trying to get access to their resources - they understand that and they do try to put processes in place. But what they are not always good at, and particularly the small charities, is that kind of ticking the box of all requirements. (Interview 4)

Members of an umbrella group typically make an informed choice as to which groups they wish to join, particularly if there is a membership fee involved. Thus, the membership will be comprised of charities with a particular interest, and in this case could be particularly aware of the problems of financial crime, although still falling short of comprehensive regulatory compliance.

A faith charity in this category discussed the possibility of being infiltrated by terrorists or those seeking to gain political advantage. This was identified as a possible risk to the charity, albeit one that had not caused concern to date. This was possibly because they thought they would be able to identify such infiltration should this happen and were particularly trusting of all those with whom they had contact, who would be of the same faith. However, there were no robust mechanisms in place in the way of formal processes to manage the risk. The informal due diligence processes, which the participant admitted might be inadequate, may comprise of discussions within trustee meetings in relation to donations and their provenance.

As there were only a few trustees who knew each other very well, matters were conducted in an informal manner, and there would be no discussion around vetting beneficiaries, even when funds were destined for unstable geographical areas. Again, the question of trust was paramount, and if funds were transferred on the rare occasion by means of informal value transfer systems, or cash couriers, no further due diligence was considered necessary. (Interview 6)

The above analysis highlights the perception of charities within this group that some aspects of the regulation may be worth adhering to, whereas others may

not be. This may be caused by a false sense of belief that the regulation may not apply to their organisation, or that they may be immune to scrutiny due to the nature of their charitable objectives or focus.

The charities comprising this group were predominantly faith charities. At all stages of the process from gathering donations to the final distribution to beneficiaries, or to partner agencies who would deliver to eventual beneficiaries, the people involved were likely to have been drawn from a particular faith group, Christian or Muslim. This would include the trustees, employees and partners. The matter of trust was raised as a factor which obviated the requirement for due diligence to some extent, by all the participant faith charities. There is therefore the suggestion that these charities may be more resistant to the idea of regulation from outside their own faith group.

Yasmin and Haniffa suggest that a lack of disclosure and accountability noted amongst Muslim charitable organisations they studied, may be due to a perception amongst this group that such 'secular' reporting activities were "peripheral and unimportant."³⁴ There was no suggestion from the participant group that accountability as such was unimportant, rather that this may be considered less of an issue for them as their activities were predicated on trust.

The Impact of implementation of the legal requirements

Amongst the aware/unresponsive group the issue of the cost of compliance was also raised, and this cost implication meant resources were being diverted elsewhere:

It is really important that we get it right and reduce our risks, but actually the costs on small charities is very large and that doesn't add to our bottom line at all, it just keeps us at the same place. (Interview 14)

³⁴ S Yasmin and R Haniffa, 'Accountability and Narrative Disclosure by Muslim Charity Organisations in the UK' (2017) 8 Journal of Islamic Accounting and Business Research 70, 81.

Charities would often comply with some aspects of the regulation and not with others. As the question of trust was prominent in this group, the due diligence considered essential to the next group was to some extent redundant. They may argue though that the 'know your' principles were satisfied in that they had a sufficient understanding of who they were dealing with. Although there would be some sympathy with this view, this may not stand up to external scrutiny.

Charities may have robust monitoring systems, especially those operating abroad and in areas of political instability, but implementation of monitoring was inconsistent. Investing resources into areas where there was little perceived benefit could be considered a waste of scarce resources, and the charity's objectives better served elsewhere. They may have considered the impact on their ongoing sustainability of partial compliance with the regulation. However, with a solid donor base and ready pool of trustees, together with well-established partnerships within the particular faith group they may be more assured of their sustainability in a tough economic climate than organisations in other categories.

Many small charities still operate in areas where terrorism and terrorist activity are a constant threat, when other larger charities have withdrawn. Some, as previously suggested, are unaware of the full extent of their legal and regulatory responsibilities, however there are also many who are aware and are driven by the moral imperative to pursue their charitable purpose regardless.

Canon White, in a recent radio interview, spoke of the pressure he was under whilst awaiting the outcome of the Charity Commission inquiry into suggestions that the charity he founded, The Foundation for Relief and Reconciliation in the Middle East (FRRME) had paid the terrorist group IS a cash sum for the release of Yazidi and Christian girls who had been enslaved. (A suggestion he emphatically denies.)³⁵

³⁵ Edward Stourton, Interview with Canon Andrew White (Radio 4 10 June 2018).

This highlights the extreme difficulties many charities face when operating overseas in pursuing their charitable objectives but also acting within the law. Canon White has since founded a new organisation, Jerusalem Merit (JM), which has not been registered with the Charity Commission 'as it places on us too many restrictions'.³⁶

4.4 Aware/Responsive

The aware/responsive category is made up of organisations that have a comprehensive understanding of the regulation and the requirements for compliance, and have established procedures, either via individuals or within the overall organisation, with the intention of maintaining regulatory compliance. These organisations may also be confident in the manner in which they respond to questioning regarding the regulation, as well as the manner in which they are responding to the regulation. In some instances, when regulatory compliance is embedded into the organisation, a culture of frequent internal audit may also be present since these aware/responsive organisations are motivated to maintain compliance levels across the organisation, as well as continuously improving their processes to maintain compliance efficiently and effectively over time.

In contrast to the unaware/unresponsive cluster, this category of organisations does have an awareness of the regulation and make a conscious decision to be responsive to their obligations in this regard. The organisational response may be initiated within the organisation itself or, in the context of this research, may be catalysed by one or more of the charitable trustees.

Factors that would indicate categorisation in this aware/responsive group could include:

³⁶ *ibid.*

- A clear and detailed response to the request for interview at the set-up stage, with no additional requests for information before agreement to participate was given.
- During the interview itself, the interviewee displayed a depth of understanding of the possible impact of non-compliance to the regulation.
- There may be more than one individual involved within the interview process, each with a specific role with regard to regulatory compliance.
- Clarity within the interview of where responsibility and accountability lay in terms of organisational compliance.
- Clearly defined procedures with respect to regulatory compliance, sometimes accompanied by internal self-audit processes.
- A proactive approach to regulatory awareness, both present day and how the regulation may evolve in the future. These organisations may be involved with regulators in active dialogue in terms of how regulation can evolve to become more effective.

Charities in this group, particularly those operating overseas and in areas of political instability, were acutely aware of the risks to the sector of abuse for terrorist financing purposes and the challenges this presented. Umbrella groups as well as some charities, especially the larger ones who were aware of the risk to the sector, believed that the extent of the risk was underestimated:

I think as a sector we probably underestimate the extent to which we are vulnerable to fraud and money laundering that would be attractive to certain terrorist financiers. The difficulty is that either a lone wolf or a very small group actually doesn't need that much money and it would be potentially in amongst the weeds, even for a relatively small organisation... (Interview 26)

The charities in this group had all assessed the risk of their charities being used as a vehicle for terrorist financing. The level of awareness and understanding of the requirements of due diligence measures was high, particularly in those operating overseas. One umbrella body particularly commented on due diligence with respect to donors:

A huge amount of work goes into charities understanding their donors and the potential risks that might come into it. (Interview 4)

This umbrella body had carried out a survey of its members and concluded that, for the most part, they did have procedures in place with respect to due diligence. Quoting a typical response to the survey:

... this is a topic in our board meetings. You know we have risk registers, these topics come up, we might even have a finance and audit committee. Well, we ask our internal auditors or external auditors to go and evaluate projects and tell us what's happening.

So, they all have an evaluation, or impact evaluation, so they will be able to try to find beneficiaries and understand what's happening with their resources. (Interview 4)

The umbrella body surveyed members had also given a similar impression with respect to risk policies though, and the participant made the comment:

... well whether they are good at it is another thing altogether; unfortunately, I don't have a chance to evaluate their risk policies. (Interview 4)

The charities who were members of this specialist umbrella group, and in particular the participants who replied to the invitation to participate, were a self-selecting group, undoubtedly well versed in the regulatory requirements. However, having policies and procedures in place does not necessarily equate to effectively carrying them out.

Only one of the study participants in this category reported rigorous procedures involving checking names of donors and beneficiaries against lists of proscribed terrorist organisations and designated individuals in the UK. They also checked UN, EU and OFAC terrorist sanctions lists routinely as well as relevant country-specific lists. In addition to this, their partner organisations were vetted and screened:

... we've been one of the early adopters, and in terms of third-party partnerships we've probably been conducting checks as far back as the early 2000s. In terms of formalised software, I'd say about seven or eight years, so it's still a relatively new environment for some NGOs but not for ourselves ... review of their governance structure, their registration, their key management, their trustees and their

finance arrangements so funds coming in and funds coming out so it's quite a comprehensive check. (Interview 7)

This multinational major charity applied due diligence checks to all employees not only as part of its standard recruitment procedure, but also on an ongoing basis:

...as part of our screening and due diligence programme all employees not just in the UK but worldwide will undergo a similar sort of check through our screening programme and then maybe additional checks... (Interview 7)

The reporting mechanisms embedded in all of the charities were also sophisticated, with many having internal audit facilities capable of extending to overseas project monitoring. A trustee from a major international charity, for example, explained the role of the auditors:

... you can be fairly confident that it has been spent on what you would expect it to be spent on, and then the auditors look at that to make sure that it's the truth, and that there is a trail, and that it's not just fabricated. So those would be the systems I would expect a charity to put in place... If there was any whistleblowing about some money and we don't know what happened to it, what that was spent on, then that would raise the level of risk and potentially the senior team, and possibly the board as well, would decide that the internal auditors should go and conduct an investigation into that, and look at it in much more depth and conduct a deep dive investigation (Interview 28)

These charities had the financial means to pay the salaries of highly experienced finance, legal and management personnel and to have the means to keep staff updated as to any developments with respect to regulation:

We are in a position that we have a pretty high-powered finance team but also our in-house lawyers and governance team who are distinctly looking at these sorts of things to make sure we are not just comply with the letter but also with the spirit. (Interview 26)

I would expect, and if they don't, they would have a problem, all of their senior staff and their finance people to be regularly updated on money laundering and terrorist financing and what that involves, and to know what to do about it, if they think there is something suspicious. (Interview 12)

However, due diligence doesn't have to be sophisticated, it should be proportionate to the risk. In some cases, the risk may be low, but the information available may not be sufficient to satisfy due diligence requirements, and further checks are required; background checks on an individual or making further enquiries. It is a question of having procedures in place and everyone within the organisation knowing what to do:

...if it was in any other scenario you might think this is suspicious, but when you understand the people and situation, well it isn't anymore. (Interview 21)

On the odd occasion that a significant amount of money has come our way that is from an odd source we have tended to deal with it by doing some background research and then having a discussion on the trustee level. (Interview 9)

A bribery risk assessment would also be carried out as part of the overall risk management process. When necessary these charities reported fully complying with regulation with respect to licenses and liaised with HM Treasury's Office of Financial Sanctions Implementation (OFSI), sometimes under very difficult circumstances.

Some within this group though reported challenges in obtaining a license in order to operate, that clearly restricted their ability to fulfil their charitable objectives. A participant from a large international charity described the challenges experienced in attempting to provide fuel to a hospital in Syria. As this constituted a prohibited activity under the Syrian sanctions' regime with no relevant exception in law, a license was required, and the relevant application made to the Treasury.³⁷ In this instance the proscribed terrorist group IS was known to be dealing in oil in order to fund operations; controlling numerous oil fields and earning revenue from its sale.³⁸

³⁷ HM Treasury Office of Financial Sanctions Implementation, 'Factsheet for charities and other NGOs' 7.

³⁸ FATF, 'Financing of the Terrorist Organisation Islamic State in Iraq and the Levant' (FATF/OECD February 2015) 13.

The process of obtaining the licence in this instance was so convoluted that the hospital did not receive the supplies in time.

Whilst the legislation was right, actually how it would operate in a humanitarian context, it just wasn't practical. (Interview 7)

Furthermore, the type of detailed information required to satisfy licence requirements potentially put peoples' lives at risk:

In a war zone it is difficult to get that type of information... where is the fuel coming from? What's the source? Even down to what refinery? What position on the map?... NPOs are thought of in some groups as being spies anyway for foreign governments, so people going in to try and deliver aid are then being asked to show ID documents. (Interview 7)

There was general recognition that the risk environment is not static, and that policies and procedures need to be revisited and updated when necessary to ensure that they are not only up to date and are effective, but also that such policies are proportionate to the risk.

The view amongst some within this group was that the regulation was neither burdensome nor excessive:

I think the regulation should be really tough-it's a matter of donor confidence and having good governance in place but also a matter of right and wrong I think- if government say is giving grants or people donating money or whatever, it is incumbent on the charity to make sure that money is spent in the right way and in the agreed way. (Interview 27)

Many charities have retail outlets as a means of raising funds, but charities within the aware/responsive group were more likely to have systems to protect their funds, including specialist software to identify unusual patterns. In one case a dedicated revenue protection team were given the remit to monitor revenue from the charity shops and look out for possible terrorist financing as part of the general financial management processes.

Terrorist financing is unusual, but we are alert to it, as shops are in some areas where you might see that type of terrorist breeding ground, if you like. (Interview 26)

Although many would be uncomfortable with implied racial profiling, potentially suggested by this comment, trustees have to be alert to the risk of funds being misappropriated, for whatever purpose that may be, and may have to be particularly wary in some geographical areas and alert to potential risks which they may not consider exist in certain other areas.

Two of the charities also saw their role as beacons of good governance for the charity sector. Several had worked with umbrella bodies both on influencing government policy and specifically influencing change within international bodies, for example to the FATF Recommendation VIII.

...largely because of this group-but it wasn't the group joined up with the government it was the group going at it with a number of think tanks and a number of other individuals out there that were or should I say the likes of Bond, Coalition Resource that went at this area and got it changed. (Interview 7)

I don't think any charities that were part of it have thought overnight this is going to change anything, but it was good to get it at a global level, recognition of it, but it's more the conversation it has prompted since. (Interview 4)

They had also contributed both individually and as members of umbrella groups to the National Risk Assessment of Money Laundering and Terrorist Financing (NRA) 2017, which resulted in the downgrading of the risk of terrorist financing within charities. (Expected to have a positive effect especially on the relationship between charities and financial institutions.) (Interviews 4, 7 and 25)

On a national level, charities were involved in active dialogue to improve the effectiveness of legislation:

A very recent initiative that we were working on together was the sanctions legislation because we were increasingly seeing that the sanctions legislation that was out there, huge NGOs just weren't aware of the actual impact or those that were putting the sanctions legislation together did not think about how it would impact humanitarian aid. (Interview 7)

All the charities identified as belonging to this group were either in the large or major size category. Those operating overseas had taken additional measures to identify risks inherent in operating in each individual country and had processes embedded in the organisation. They were also members of large international umbrella organisations and interest groups and used their influence to bring about policy change at national level and within international organisations.

The impact of implementation of the legal requirements

Organisations in the aware/responsive group were not so much concerned about the cost of compliance of this regulation in particular as they reported having both financial capacity and expertise available. In addition, there would be risk management procedures in place covering a range of possible risks, to which terrorist financing risks could be added without great additional cost. The visibility of compliance was essential for this group. As beacons of good governance, they were concerned about their image and maintaining donor confidence. With high value grants at stake, negative media coverage and a change in public attitudes could have a devastating effect on the income of these predominantly major-sized organisations.

In contrast to the faith charities in the previous group, the participant from a major faith charity in this group was very concerned about the potential cost of 'getting it wrong' and felt they were under the media spotlight as a Muslim charity. Ensuring all possible compliance measures were in place was considered a priority. The financial cost of implementation, and procuring the necessary expertise to facilitate this, was considered essential.

For the other international charities within this group, compliance was also prioritised. The motivation to some extent was to make their compliance visible, in order to tick the relevant boxes, but the cost for them was to some extent more of an issue. However, according to an umbrella body that counted many

international charities amongst its members, they were also unlikely to be vocal about any opposition they may have. (Interview 25)

5. CONCLUSION

The analysis presented in this chapter has focused on implementation of the regulation in practical terms and addresses the question of how the regulatory requirements impact on the operations of charities by analysing the level of awareness of the regulation and the response to it. Some of the factors influencing the level of engagement with the regulation amongst the participant group and the corresponding responses have been discussed; the role of the trustee, availability of expertise and information, cost, internal culture and attitudes, compliance procedures and technology. The impact has varied according to the ideal types.

The unaware/unresponsive category were, for the most part, unaware of the risk to the sector generally, and had taken no steps to assess the risk to their organisation. The risk may in reality be low, however, as a matter of good governance the question of risk of financial crime should be addressed. This message does not appear to have reached this group, and participants from umbrella groups were particularly critical, attributing lack of awareness in part to a lack of understanding amongst trustees of their role. The impact of this deficiency may be particularly acute in operations identified as high risk, such as aid convoys and charities operating in areas of political instability where sanctions may be in place. There has been some recognition by the Charity Commission that, in the context of aid convoys in particular, for some charities the legal position is unclear and there is insufficient awareness of what they are expected to do.³⁹ This lack of awareness more generally has been apparent in discussions with many of the participants. The question of the quality of advice available to support their decision making has been explored in this chapter and will be discussed further in Chapter Eight, where alternative avenues for the

³⁹ Joint Committee on the Draft Protection of Charities Bill (2015) 'Draft Protection of Charities Bill' (Report HL Paper 108/ HC 813, 3 February 2015).

provision of guidance were identified as a relevant theme in the analysis of the interview data.

The unaware/responsive group displayed a commitment to regulatory compliance in general but were unclear as to what they were responding to in relation to the CTF legal framework, perceiving a lack of clarity with respect to the regulatory requirements. Accessing information and guidance was problematic for this group, who also cited cost as a limiting factor in this regard. Unlike the previous group, several participants were members of umbrella bodies although engagement with these was limited. The burden of regulation in general was considered disproportionate, with an increased level of scrutiny causing anxiety which, in some cases, met with an over-zealous and inappropriate response. Again, risk management processes within the organisation, if they existed, were not well understood by this participant group.

The aware/unresponsive group experienced a number of similar challenges with the regulation, for example the potential cost, which meant scarce resources were diverted away from their core purpose. The question of proportionality of the regulation arises in this group and was raised as an issue more often than in other groups as participants cited scepticism with the utility of some of the due diligence measures expected of them, for example relating to sanctions lists, and measures that were putting the safety of their staff at risk. There was therefore a real sense amongst these participants that the regulation was onerous and disproportionate to the risk that the regulatory requirements were trying to address.

The final group in the aware/responsive category were concerned to a greater extent with the visibility of compliance. There were, however, significant challenges with regulatory compliance in specific areas, for example, with respect to obtaining licenses and navigating sanction regimes, for which the regulation was to a considerable extent an impediment. This analysis therefore demonstrates that some charities are not implementing the regulation, for a variety of reasons, when a risk analysis would probably indicate that they

should pay greater attention to due diligence and other compliance measures. Even for those apparently implementing the regulation effectively this may ultimately restrict their ability to fulfil their charitable objectives.

Several of the themes that have been considered in this chapter for example; whether the risk of financial crime is adequately addressed, the cost of compliance, the impact of sanctions legislation on the delivery of humanitarian aid, and whether faith charities face particular challenges which need to be addressed, will be revisited. In the next two chapters discussing engagement with the regulator and with third-party commercial partners, the direct and indirect effects of the CTF legal framework will be explored further.

CHAPTER 7: ENGAGEMENT WITH THE FINANCIAL SERVICES SECTOR

1. INTRODUCTION

The financial services sector has increasingly been relied upon in the fight against terrorist financing, particularly since the events of 9/11, and some of the challenges faced by the sector have been outlined previously with respect to this role.¹ This chapter addresses the question: to what extent do matters of regulatory compliance impact on relationships between charities and financial institutions? The challenges/opportunities arising for charities from this engagement are highlighted, and the analysis of the interview data contributes to addressing the overarching question; to what extent is the CTF legal framework effectively implemented? And how does the CTF regulatory environment affect the capacity of domestic charities to fulfil their charitable purpose?

The tougher regulatory and enforcement regimes that banks and MSBs have been subjected to since the global financial crisis have resulted in severe penalties for financial institutions that contravene counter-terrorism legislation, and fall foul of AML/CTF regulation, either knowingly or unknowingly. 'De-risking', the withdrawal of financial services deemed too risky, is therefore seen in some cases as a clear commercial choice, as discussed in Chapter Five. Banks are also regarded as key partners in the application of international sanctions regimes and in counterterrorism legislation. In this chapter the engagement of charities with their financial service suppliers will be discussed; from charities accessing banking services and their ongoing relationships, to the more complex and problematic situations arising when banks decide to de-risk and terminate the relationship with the charity.

¹ Chapter Four s.5.2.2: Chapter Five s.5.

This exploration of the interface between the parties will be made with particular reference to the interview data, gathered through discussions with charity trustees and managers, and with participants from the financial services sector. Other parties having in-depth knowledge of the relationships between charities and their financial service providers were also interviewed, including solicitors and accountants with expertise in the charity sector.

In the analysis of the data it became clear that there were several factors that could possibly influence the relationship of charities with their commercial partners. These factors, identified in the first part of the chapter from the perspective of both charities and their financial service providers, assisted the researcher in identifying 'ideal types' which would then form the basis of the analytical framework. This analytical framework served as a lens to compare, contrast and analyse the interview data, and such analysis will form the second part of the chapter.

2. THE OPERATIONAL ENVIRONMENT

In the previous discussion of the complex and constantly changing environment in which terrorists operate, and the means of dissemination of funds for acts of terrorism, the potential vulnerability of all financial institutions to facilitate illicit funds transfer has been highlighted.² In order to provide further context to the data analysis, some consideration of the environment in which financial institutions are now operating would be useful, which has much to do with the tenor of the communications emanating from institutions such as the FATF and the UK government. As highlighted previously in Chapter Three, the FATF had identified the NPO sector as 'particularly vulnerable' to exploitation by terrorists, describing a 'particularly egregious form of abuse that fundamentally undermines public trust in the NPO sector'.³ The messaging could be perceived as stark and uncompromising. The effect has been to engender increasing

² General discussion Chapter Three, and particularly s.5.1.

³ FATF, 'Risk of Terrorist Abuse in Non-profit Organisations' (FATF/OECD 2014) 4.

restraint when dealing with NPOs. There is some evidence that the tenor is being modified,⁴ however, this has not necessarily translated into increased confidence in the NPO sector. Financial institutions have also been identified as vulnerable to abuse but are relied upon as a key partner in the government's strategic response to terrorist financing. There is therefore pressure to fulfil this role, but also to treat prospective commercial partners with increasing caution.

The rhetoric from the government though has been largely supportive of charities, recognising the valuable service they perform often in difficult circumstances, for example, the UK joint committee on the draft Protection of Charities Bill noted that charities operating overseas were experiencing the 'chilling effect' of laws designed to counter terrorism 'at a time when their efforts are possibly more critical than ever before'.⁵ The difficulty generally in assessing the extent of abuse of charities for terrorist purposes in Syria, for example, was highlighted by the metropolitan police counter terrorism network.⁶ The issue is subject to current debate, and an area of concern to those in the financial services sector dealing with charity clients.

The Charity Finance Group, which has been at the forefront of addressing the problem of bank de-risking and the effect this is having on charities, note that 'the tone of regulators and governments makes banks nervous'.⁷ There are numerous examples in recent times involving IS and its financing which would exacerbate this unease. This has been the subject of a detailed report by the FATF, which highlighted, for example, the risk of involvement of NPOs in foreign donor support for terrorists, and the risk associated with wire transfers from charities to areas of known IS activity.⁸

⁴ See discussion on NPOs vulnerability to abuse, Chapter Three s. 3.2.2.

⁵ Joint Committee on the Draft Protection of Charities Bill (2015) 'Draft Protection of Charities Bill' (Report HL Paper 108/ HC 813, 3 February 2015) 53.

⁶ *ibid* para 34.

⁷ Andrew O'Brien, 'The Threat of De-risking Continues to Haunt Charities', (Banking Guide, Charity Times 2017) 33.

⁸ FATF, Financing of the Terrorist Organisation Islamic State in Iraq and the Levant (ISIL) (FATF/OECD February 2015) 18-20.

Furthermore, guidance to the financial services sector provided by the Joint Money Laundering Steering Group urges greater caution in dealing with certain groups, including some charities.⁹ Such advice undoubtedly serves to increase surveillance and may affect the risk appetite to deal with these ‘high-risk’ entities.

From the banks perspective though there is no generally agreed means of assessing financial crime risk, unlike other risks they may have to quantify, such as consumer credit loss. A client may be identified as falling within the ‘high risk’ category (for example by sending funds to areas of political instability) but the risk may actually be lower. Identifying the criteria for accepting this risk may in practice be ‘attempting to prove a negative’ and as such difficult to justify.¹⁰ This difficulty has also been identified within the category of MSBs, which may be identified as ‘high risk’ in certain areas. Identifying which individual MSB may pose a lower risk, and one which can be accepted is infinitely more challenging and the bank may decide this is just not worth the effort.¹¹

A lack of engagement of government with the charity sector, and between government departments in identifying and addressing the problem created by bank de-risking is highlighted by Keatinge and Keen. They identify a conflict of objectives which needs to be addressed, between HM Treasury, charged with enforcement of sanctions regimes and the government’s Department for International Development (DFID) in pursuing its objective to deliver overseas aid, including states in unstable and high-risk areas.¹²

The triggers for excluding bank clients therefore may come from a variety of sources, which could be influenced, for example, by statements from international bodies, guidance from sector-specific regulatory bodies or from an

⁹ JMLSG, ‘Guidance for the UK Financial Sector Part II: Sectoral Guidance’ (2017) para 1.37.

¹⁰ David Artingstall and others, ‘Drivers and Impacts of Derisking: A study of Representative Views and Data in the UK’ (John Howell and Co. Ltd 2016) 8.

¹¹ *ibid.*

¹² Tom Keatinge and Florence Keen, ‘Humanitarian Action and Non-state Armed Groups: The Impact of Banking Restrictions on UK NGOs’ (Chatham House 2017).

internal review of existing clients, which would take place on a routine basis.¹³ Thus, the transactional environment in which the parties operate, including banks and other financial service providers as well as charities, could have a significant influence on the behaviours displayed.

3. FACTORS THAT MAY INFLUENCE THE NATURE OF THE ENGAGEMENT OF CHARITIES WITH THE FINANCIAL SERVICES SECTOR

In the analysis of the data it became apparent that there were numerous factors potentially influencing the relationship between charities and financial institutions either pertaining to charities themselves, or to banks with whom they may have dealings.

3.1 Charity-related factors

3.1.1 The history and heritage of the charity

The length of time a charity has been in existence, the track record that is available for public view and other indications that the charity has been well run over a period of time, may be important factors in the relationship between charity and bank. A well-established charity would be in a position to prove its credentials of financial stability to a bank in its record of annual accounts and other statutory requirements, in a way that a newly established charity would not. Other indications of trustworthiness and reliability may derive from having no track record of investigations from regulatory authorities, for example, the Charity Commission or law enforcement bodies.

Investigations of charities have led to difficulties in accessing financial services. In the US, for example, the charity 'Life for Relief and Development' reported difficulties in securing banking services after being investigated by the Federal Joint Terrorism Task Force. Even though no charges were brought against the

¹³ Artinstall (n 10) 9.

charity, only one bank would facilitate the wire transfer of funds, but only in adhering rigidly to supposedly voluntary Treasury guidelines.¹⁴

An established charity would also be able to show the history of senior office holders in management and on the board of trustees. The charity would therefore be able to present a proven track record of stability (and perhaps growth) as well as a history of regulatory compliance, or at least a lack of non-compliance. The ability to demonstrate a track record of effective and efficient administration, may have a positive influence on a financial services provider in the decision-making process as to whether to accept the charity as a client.

3.1.2 How the charity evaluates the sources of funds

The means by which a charity evaluates the source of funds and the scrutiny that is applied to this, may affect the relationship with the bank. The charity should be able to provide information with respect to the processes in place and have well defined assessment criteria in this regard. There may be a level of donation, for example, above which certain enquiries are made, and the charity should be able to provide this evidence of transparency to the bank.

A charity which had been receiving occasional large donations through the bank without knowing who the donors were, suddenly received an urgent request for an explanation regarding another particular donation:

He made quite a significant donation \$50,000, and immediately the bank was after us saying 'how did you get this money?' (Interview 6)

If called upon to explain the previous donations of substantially larger amounts however, he would not have been able to do so. The receipt of anonymous sums by a charity is not prohibited; a bank may require sight of the audit trail of such

¹⁴ Charity and Security Network, 'Negative Impact of Post 9/11 Counterterrorism Measures on Charities, Donors and the People They Serve' 2011
<https://charityandsecurity.org/sites/default/files/Impact%20of%20Counterterrorism%20Measures%20on%20Charities%20Donors%20and%20the%20People%20they%20Serve.pdf>
accessed 1 March 2020.

transactions though. A charity may also refuse to accept a donation if it is suspected of deriving from an illegal source, such funds may have been offered to the charity in a wrapper of anonymity. Otherwise the source may not be in alignment with the organisation's charitable objectives, and as such the charity may decide to decline.

The charity should also be prepared to offer an explanation of how donations are audited and provide a record of donations that have been declined, together with a record of the decision-making process behind those decisions.

3.1.3 How the charity selects how and where the funds are distributed

The presence of internal systems and processes within the charity could demonstrate how charities weigh up the various options open to them regarding the distribution of funds. The decision may be based on the personal preference of the CEO, and may be purely speculative, or based on decisions made by one or two trustees, as opposed to a decision resulting from a well-structured ranking system. If a charity were to approach a bank wishing to open an account, the bank may ask to see a portfolio of decisions on which projects were funded, or how otherwise the monies had been distributed, based on the mission and objectives of the charity, and demonstrating a business-like and professional approach. This is equally important in the ongoing relationship with the bank. The organisation should have a well-defined financial strategy in place reflecting the charity's values and outlining their aims in order to fulfil the charitable purpose.¹⁵

For example, a major international charity participant understood the importance of having a financial strategy in place and the benefit of proactively sharing this with the bank's relationship manager: communicating information such as how a project would be affected over a defined time period and how monitoring of the project would take place:

¹⁵ MHA MacIntyre Hudson/Charity Finance Group, 'Essential Charity Finance for Trustees' 2017 19.

All this provides some reassurance to the bank that we have it under control...we send funds to Nigeria amongst other places, so we, and yes they do too, have to be careful: so the finance director explaining the 'how and why' when it comes to selecting where funds are going is important, and I think that helps. (Interview 27)

Thus, having a clear and demonstrable strategy with respect to funds distribution can provide additional evidence that the charity is well managed and inspire confidence in the organisation.

3.1.4 Transparency and audit trail

Charities should be able to provide a clear outline of the processes followed in relation to financial flows, and how these are audited, as a matter of good governance. Money is a regulated commodity. It should still be possible, however, to accept and dispose of funds and transact in higher risk situations if the relevant controls are in place. This is done, for example, in the chemical industry with the handling of highly dangerous, toxic or inflammable substances by means of a high level of control and accountability to demonstrate to the Environment Agency that the commodity is produced and distributed to the end user safely.

Several participants described robust processes demonstrating transparency of finances and regulatory compliance within their organisation, including meticulous accounting processes and the monitoring of large amounts of small payments by means of a spot check system, (Interview 20) and carrying out sophisticated internal audits:

In an organisation that you might have given £50 million to, so they can deliver certain services in a part of Africa, you will see what it has been spent on and that will have been audited as well... In terms of the risk register and working with the internal auditors, you would have an audit plan as well... (Interview 28)

Others also included financial awareness training for members of staff, so all should be aware of what is expected of them in terms of financial processes.

(Interview 26) Amongst the smaller charities generally though this was not the case. This was also a finding of a recent report in which only 56% of respondent charities provided charity finance training to trustees who were deemed to need such training.¹⁶

A charity is more likely to have a collaborative relationship with the bank if it is open and transparent about its financial flows, can produce an audit trail of transactions, can demonstrate compliance with regulation with respect to their financial accounting and demonstrate that staff are adequately trained.

3.1.5 Relationships between senior management within the organisations

Many charities are run and operated largely by volunteers, and there is often a high turnover of personnel within the charity, including the trustees. Consequently, this can create difficulties when the charity is trying to forge a relationship with the bank as there is no obvious point of contact.

From the bank's perspective the fast turnover of personnel created challenges:

You may well have several trustees one minute and they might be very heavily involved, and this may change. You don't know who these people are. It's all about understanding who the customer is, so I think if transparency improved, this would help matters...Whenever we were dealing with a charity from an onboarding perspective, it would take forever trying to find out who is who, and it was something that we didn't enjoy when we were trying to set up the account, so the whole thing would take a long time. (Bank compliance officer Interview 17)

A participant from a charity that had an account closed intimated that a poor relationship was a possible causative factor:

I think it was because of the way the previous chair interacted with them. (Interview 23)

¹⁶ CFG/MHA, 'Survey: Trustee Charity Finance Competency' 2019.

The bank may appoint a relationship/account manager, but this was more likely to be offered to the larger charities. Most of the smaller charities reported having no one to discuss specific issues with.

Despite having been appointed a relationship manager, a participant from a major charity had not found this particularly helpful though:

This sort of due diligence work is always done by different departments. There seems very little interface at all. You can complain to your account manager and they will just say ‘you have to do it.’ There is a lack of communication and that sort of thing. (Interview 13)

From the perspective of many of the charity participants their financial services providers had very little understanding of the nature of their business. When major problems had occurred, for example, threatened or actual account closures, the relationship between charities and their banks were particularly confrontational. (Interviews 14, 15, and 23)

There was evidently both a poor relationship with the bank and a notable lack of communication between the parties within several of the participants interviewed. A lack of communication between charities and banks was also noted in a survey of members of the Charity Finance Group, reporting that 60% of respondents did not regularly discuss their operations with the bank or keep them informed of their plans for future development.¹⁷

Clearly these factors, as highlighted above, could have a significant impact on the relationship between the parties and could actually be within the control of the charities involved. If charities were aware of this, they could take positive action towards improving these relationships.

3.2 Bank-related factors

Participants from the financial services sector highlighted certain factors which may influence their relationships with clients relating to their perception of risk.

¹⁷ O'Brien (n 7) 33.

3.2.1 The risk appetite of the bank

Some of the challenges for banks concerning risk management have been highlighted previously, for example, a perceived intolerance for unintended regulatory breaches and the escalating cost of regulatory compliance.¹⁸ It is clear from the comments from participants from financial service organisations that risk management is a very real concern and one that is central to their relationship with clients.

A participant from a major UK based international bank rationalised the current situation in which they operate, as stemming from the transfer of responsibility for AML/CTF to the financial services sector, when the UK government made the decision that they were no longer able to police this area.

So now the banks' risk assessment is not of the entity they are banking, but the risk assessment is based on the catastrophic cost of them being discovered that money laundering or financing of terrorism is taking place. As soon as there is evidence of this, then the banks are fined. They don't go through the judicial process, it's the equivalent of being caught on camera speeding, there is nothing you can say. That is incredibly onerous. (Interview 34)

A participant compliance officer from a large international bank outlined the problem from the banks' perspective of having to cope with this relatively new area of regulation:

... it is something that has come about very quickly... Over the last 10 years or so the regulation has been very strict and there has been far more clamping down and challenging banks to improve on some of their controls ... when it comes to anything to do with charities ... banks would consider many of them risky. (Interview 17)

These financial institutions therefore may be operating in a high-risk environment, but one in which many consider there is insufficient guidance to help them navigate through, which does nothing to moderate the risk.

¹⁸ Chapter Five s.5.

A participant compliance officer found this to be the case and highlighted his experience working with different banks:

... it's not very clear on what the expectations are, so for every bank you have to interpret vague guidelines and then implement them within their systems, but it's quite a challenge. (Interview 17)

The British Bankers' Association (BBA) have also highlighted the problem for the sector; not only relating to the large volume of CTF/AML guidance documents, but also the inconsistency between such documents issued by various international bodies. BBA members have reportedly found the guidance both confusing and unnecessarily complex.¹⁹

The term 'onboarding' describes not only the process involved in taking on a new client, but also the ongoing relationship between client and bank. There have been certain challenges identified from the banks' perspective in pursuing the 'know your customer' requirements, beginning with the high expectations of clients for easy access to financial services. The decline in face-to-face contact due to the prevalence of online banking and lack of accessible branches to facilitate this contact is also a trend that could affect the banking relationship. The frustration from both parties with the length of time taken to properly investigate a potential new client has also been in evidence.²⁰

Many of the charity participants found the level of enquiries made of them by the bank incomprehensible and participants offered numerous examples of their frustration with the process, for example:

We have had a repeated conversation...I have said 'well I don't have anything, you have had everything I have already...we don't do it that way', and then eventually it will stop, but you have that kind of conversation quite a lot. (Interview 13)

¹⁹ BBA, 'Response to 'Cutting Red Tape: Review of the Effectiveness of the UK's AML Regime' (Consultation response, 2015).

²⁰ PWC Financial Services, 'The Future of Onboarding' (December 2016) 4.

...it's the constant requests for information -for some charities it's getting to the point that every time they transfer money to some of these locations it's a few weeks' worth of work to try to reassure the banks and make sure they provide the information that's required. (Umbrella body - Interview 4)

Keatinge and Keen also reported that British humanitarian NPOs, in particular those operating in countries under sanctions, were subjected to enquiries and questioning from their financial service providers, which they considered were disproportionate to the risks. One organisation reported in the region of 600 banking compliance enquiries in 2015, in contrast to less than 75 enquiries in the previous year.²¹

In order for the bank to assess the risk of taking on a charity client, there is an expectation that the potential client will be transparent as to whom they have dealings or partnerships with. This however was not always found to be the case:

From an onboarding perspective, the charity might describe themselves as operating domestically and that there is a low risk. But then when you look into it, and delve into it a bit further, you may find that some of the people that they manage, or the initiatives that they get involved in, touch base with high-risk entities; with other charities or organisations in high-risk areas. (Interview17)

If the bank is not able to satisfy itself that the risk falls within its own risk appetite, it may decline to offer its services.(Interview 33) A bank compliance officer, having extensive experience across other banks and prior experience dealing with charity clients, considered that the decision to 'de-risk,' would only be made following a rigorous due diligence process:

There was a high focus on due diligence before a decision would be made. There would be a subjective view taken on the basis of risk after gathering as much information as possible on who was going to access the accounts, where the funds were coming from, and information on what the charity is going to be doing, and where the money is going to be invested and their fundraising etc. All these factors are considered when making a judgment about the risk. This will probably never become public though, but they would have made decisions based on facts, and taking a risk-based approach, as opposed to just not being comfortable and stereotyping a charity as being high-risk with no factual justification. (Interview17)

²¹ Keatinge and Keen (n 12) 13.

Banks are run as commercial enterprises, and as such may make the decision not to provide banking services to a charity. All bank customers are subject to a periodic review as a means of continually managing risk, thus banking services could also be withdrawn on this basis. With respect to this review process, clients are expected to continually respond to requests for information for the duration of the banking relationship. (Interview 33)

Furthermore, the cost of running charity accounts is higher than for other commercial clients as the bank charges are generally lower.

So, the cost (to the banks) is higher, and the risk is higher, so then you can understand the need to ensure that you get it correct. (Interview 17)

Several charities though considered that banks should make greater concessions to them due to their charitable status:

...that incurs a 1% charge when you're paying it into the bank (cash) ...whereas they could offer a discount, well free of charge for paying it in through a machine, so the pricing model doesn't really work for us. (Interview 23)

Of wider concern for banks is the potential for external influence, from the US for example. US dollars are used globally and have to be cleared by the US banking system, even if initiated and destined for locations outside the US.

If a bank gets pulled up by the US regulator, they can threaten to remove their US dollar clearing; that spells disaster for the bank, they can't trade and would go out of business. (Interview 34)

This threat therefore could exert a powerful influence on the behaviour of the bank and its attitude to risk, which may include the clients, including charity clients, with whom it is willing to do business.

3.2.2 Reputational benefit for the bank

The authors of a report by the think tank DEMOS recommended that banks should acknowledge that they have a 'key and supportive role to play in society and thus need to look beyond their innate profit motive'.²²

Banks may consider that, apart from the commercial benefit that may accrue from their relationship with a charity, there may be some reputational benefit arising from this relationship, one that is 'good for image'. The commercial benefit of providing services to a major client is clear, however that benefit may diminish, for example, if a charity loses its funding streams and becomes a less profitable client of the bank as a result. In the aftermath of the recent Oxfam scandal, donations to the charity plummeted; the CEO Mark Golding reported a loss of approximately 7000 direct debits. He also stated at the time that corporate partners were 'reserving judgment' and would examine how their particular relationship may have been compromised.²³ It is difficult to assess the reputational damage to a bank by its association to the charity, but the bank could possibly be one of the corporate partners assessing their future relationships with the charity.

From the perspective of participants from financial institutions there are clearly concerns with respect to risk, and possibly also reputation, that may affect their relationship with charity clients. The tension between the two bodies is evident, for example, with respect to the banks' requirement for information in order to manage risk, and the willingness of charities to supply this. This tension is discussed further in the forthcoming analysis.

4. THE ANALYTICAL FRAMEWORK

During the interviews with the participants it became clear that there was a wide range of opinion and experience of relationships with banking service providers, which was deemed worthy of further investigation. There was also a

²² Tom Keatinge, *Uncharitable Behaviour* (DEMOS 2014) 83.

²³ Rebecca Cooney, 'Oxfam has Lost About 7000 Direct Debits Since Scandal Broke' (*Third Sector*, 20 February 2018) <https://www.thirdsector.co.uk/oxfam-lost-7000-donors-scandal-broke/fundraising/article/1457578> accessed 1 March 2020.

very varied level of use of financial services, from the straightforward; banking of cash donations or use of banking services to collect regular standing orders and similar commercial transactions, to more complex international transactions to countries of political instability, which may be perceived as being 'high risk' transactions by the bank. The complexity of banking requirements was not, however, dependent on the size of the charity, as some of the smaller charities had complex financial service requirements. In the analysis of the data these two aspects appeared to offer an interesting basis for further exploration of how the charities engaged with the financial sector.

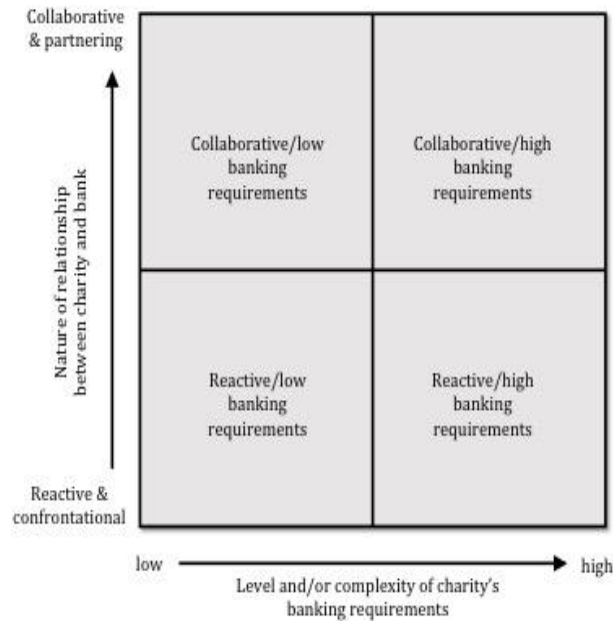
The framework for analysis proposed serves to contextualise the responses of the participants, and the two themes identified for this purpose concerned the level of financial services required by the charity, and the nature of the relationship that the charity experienced with the provider of these services, which in most cases were their bank(s). Thus, the axes chosen for this framework were the 'level and/or complexity of the charity's banking requirements' from low to high and the 'nature of the relationship between charity and bank' from reactive and confrontational to collaborative and partnering.

For the purpose of this analysis the relationship the charity has with their bank is based on how, from a qualitative perspective the charity participants commented on and viewed the relationship. Their perspective was ascertained either by their direct comments on this relationship or by explanations and examples that were given to support or suggest this view.

With the two above-mentioned axes the comments made by the participants can be framed into four groupings, as illustrated in Figure 7.1. Participants' comments have been analysed with reference to the four groups, as described below, which provide a lens by which the responses can be both interpreted and classified. Of the total number of charities interviewed, there were more within the category of lower level and/or complexity of banking services required than those requiring a higher level of services (the horizontal axis) but the

distribution between the relationship with the financial service provider being either reactive or collaborative (the vertical axis) was even.

Figure 7.1



5. ANALYSIS OF THE DATA

5.1 Reactive relationship/low banking requirements

The perception of the participants in this group with respect to their banking relationships were overwhelmingly transactional and operational. They recognised the need for banking services, which may have been adequately met without undue difficulty. They may therefore have no further requirements for such services. However, in the cases where they were required to respond, for example, to requests for information, this was delivered in a reactive manner. The transactional nature of the relationship meant that charities were merely complying with the banks' terms and conditions of business. In some cases, there was little understanding of the reasoning behind the requests for

information. The participants in this group proceeded in the knowledge that if compliance were not forthcoming, consequences would flow from this, which made for a more confrontational relationship.

Several of the interview participants and their organisations can be categorised into this group. Factors that could indicate such categorisation include:

- Use of banking services is at a low or moderate level in terms of value of the transactions, although there may be a larger volume of small transactions.
- The income of the charity is cash-based for the most part.
- There is more likely to be a small number of specifically defined funding sources.
- These organisations would not attempt to make regular complex transactions, but may make transactions overseas, or receive monies from donors overseas only occasionally.
- The focus is likely to be narrow, possibly limited geographically and to be on minority interests or on those of a specific group.
- The popularity of the organisation tends to be limited to a particular sector of society.
- The relationship with the bank/ banks (as several has more than one banking services provider) can be characterised as being reactive and transactional in nature.
- The charity perceives the relationship as confrontational with little or no dialogue with the bank.
- The charity is likely to be micro to medium in size.

The charities in this category all reported challenges with their banking provision and the relationship with their bank, which for some affected their operations to a significant degree.

Some charities reported difficulties in administering their accounts, and the range of services offered was considered inadequate. A trustee from a micro charity reported:

They have been absolutely hopeless, (the bank) but the difficulty is that nobody wants to take a charity on now. It's very hard to have a bank account with a small charity...the problem we have with them is simply that they are providing us with their very basic 1960s banking service, which involves cheques and statements and going to the branch, which is fairly pathetic in the 21st century.

(Interview 19)

Several charities reported that direct debit provision was no longer available to them, causing time-consuming administrative problems:

We can't do direct debits-we're not allowed to, which is a nightmare particularly when we change the membership rates, but we have issues with standing orders going missing, and trying to deal with the bank is a nightmare. (Interview 19, also similar problem reported in Interview 31)

Others reported a general lack of cooperation by the bank when requests were made. A charity client required banking services, which the bank appeared reluctant to provide, giving the impression that they were not valued as a customer.

...you try and change a mandate once you have set it up or if we want online banking or to change an authority, they are almost obstructive. (Interview 21)

Other challenges pertained to the high level of cash donations typically received by many charities. With many banks now operating exclusively or predominantly online (including those described as charity banks) one charity reported difficulties in both depositing cash, as banks refused to accept coins from collecting tins, and obtaining access to petty cash occasionally when required. (Interview 24)

The smallest charities recognised they were not very profitable for their banks and considered this the reason for the poor service offered. (Interview 19, 22 and 31)

A participant from a national umbrella body believed that the problem derived from current cuts to banking staff, as well as the question of profitability:

If there were a concern or problem, there would be no one with whom this could be discussed. The only interaction with the bank may occur when a request for information is sent out, a transfer is blocked or, in the extreme case, when an account is closed with no prior warning. (Interview 4)

Many charities regretted the demise of the relationship manager and commented that there was no one who understood the business of the charity, and no attempt was made by the banking staff to build a relationship with them.

Obviously, nobody (from the bank) has any clue what is going on: neither do they appear interested in finding out. (Interview 19)

Many high street banks have been subject to restructuring and centralisation, resulting in the closure of high street branches. Local branches which may previously have serviced charities and other small businesses in their area are more likely to be run by low-paid staff with no decision-making ability, according to a participant former bank manager:

Charities going to large banks (for an account or requesting a financial transaction which may be extraordinary) would have no chance if they were considered risky. Someone in an office looking at the criteria and making the decision, can they tick the box or not? If not, the application or request would get rejected- it is an internal system they have to follow. It may go to a higher authority, but if the correct procedure has been followed, it is likely that the same decision will be approved. No one is going to challenge from within the bank if it's a small charity or other organisation. They just don't have an incentive to accept risk for virtually no material gain. (Interview 33)

Several charity participants remarked on the nature of the transactional relationship, which derived from banks demanding information, to which the charity was expected to respond unquestioningly. The charities typically reported unusual/ onerous requests for information for which no or little explanation was given, and this had resulted in some degree of break down in the banking relationship. Furthermore, they reported negligible effort made by their banks to understand their position. There was little evidence though of

participants in this group having made any attempt to proactively approach the bank in order to improve the relationship.

A trustee from a medium-sized faith charity had noticed increased scrutiny from the bank in the past year. The reaction to a large donation from overseas triggered enquiries from the bank, and followed up with further requests for information, unrelated to that particular transaction, which he found both incomprehensible and intrusive:

...but they're asking detailed information about how many citizenships they (the trustees) have and things like that. I don't know what the implications are. I don't think really, they would be asking this of other charities; I mean non-Muslim charities... I don't know what to make of it - it feels intrusive. ...because if they have asked for details, and if we don't provide them, they will stop our account and we will be really stuck then. (Interview 6)

Perceiving a certain antagonistic attitude toward the charity, the participant enquired about opening an account with another bank but found the initial requests for information equally probing and decided against this course of action for the time being. He had considered the consequences to his charity of account closures though, and this was a constant concern.

A participant from a firm of charity accountants was also aware of charities causing concern to their banks due to the nature of the donations:

They may be asked to explain the provenance of some payment. Just as I (an accountant) may spot a payment and ask questions, so the bank may also query an unusual transaction... that's often because of where the funds originate. Funds coming from Saudi Arabia, Pakistan etc.... I think some Muslim charities think they are unfairly targeted, and they have to work especially hard to show they are carrying out due diligence, but there is going to be more wariness from the banks when money is coming or going to certain areas where there is known terrorist activity. (Interview 30)

Several participants recognised that banks were no longer prepared to offer services to 'unregistered' charities; those who are not required to register with the Charity Commission and were generally becoming "choosier" about smaller charities, as well as introducing administrative barriers. This included imposing multi-signatory requirements to documents and making onerous requests for

information when an office-holder leaves and is replaced by another. This resulted in dissatisfaction with the banking services on offer, a view shared by all the participants in this group:

...dealing with the bank has become so difficult and problematic. We tried to move money online and it required two people and key fobs; it was like extracting teeth... We are reluctant to move to another bank; it may not be any better, but someone at the bank might just say, "well let's close the account", and use some reason for that. (Interview 21)

For another medium-sized charity, the spectre of account closure became a reality. The participant described the scenario leading to the account closure as a succession of particularly onerous requests for personal information and other requirements from the trustees, for example:

...an issue around signatories, so they weren't very clear with what the requirements were, which caused a lot of stress and tension and resulted in us being removed. (Interview 23)

In this instance the charity was able to open another account elsewhere. This has not been the case for other charities, and the consequences of account closures will be discussed with respect to the next category of charities.

A participant, with experience working with many charities, noted the challenges in responding to the banks' requests for information and other due diligence requirements:

Some of the controls, for example, from Charities Aid Foundation (CAF) are almost Kafkaesque; the situation you might find yourself in...I do think it has got so complicated that it makes it very difficult for a small charity to function... it's almost as if you're set up to fail, and I think we have to be very careful that we don't stifle the best of the charitable sector...(Interview 9)

From the banks' perspective though, the onboarding process must include the minimum statutory requirements of due diligence but may also include matters such as tax residency or gaining information with respect to employment and may extend to various aspects of customer profiling carried out for commercial

reasons.²⁴ Thus, a whole array of checks may be made in response to; statutory requirements; core obligations as required by the Money Laundering Regulations,²⁵ or in response to guidance by various bodies such as the Joint Money Laundering Steering Group (JMLSG). They may be made as a result of the bank's assessment that enhanced due diligence is required, again in line with regulatory body guidelines.

For the charities in this group, however, the requests for information were overwhelmingly viewed as intrusive and obstructive and they saw little evidence that banks were prepared to gain any understanding of their particular circumstances. Those that did fully comply with due diligence requests felt that their efforts were unrewarded, and certainly no consideration was given to the time and cost of their compliance. Furthermore, there was a sense amongst participants that information requests from banks were disproportionate to any benefit they could hope to gain with respect to compliance.

5.2 Reactive relationship/high banking requirements

Organisations grouped into this category, in contrast to the previous group, described their requirements for banking services as much higher. In describing their banking relationships, the perspective of the participants could be categorised, as with the previous group, as reactive, transactional and confrontational.

The charities in this group may be categorised as follows:

- The value of the transactions is generally higher. There may also be a large volume of small donations or the charity's income may derive from large donations, possibly from an origin overseas.
- The income of the charity is more likely to derive from multiple sources.

²⁴ JMLSG (n 9) part 1 ch 5.

²⁵ For example, The Money Laundering and Terrorist Financing (Amendment) Regulations 2019, SI 2019/1511 entered into force 10.1.2020, requiring enhanced due diligence on business relationships in high-risk third countries.

- These organisations may make complex transactions and have dealings either directly or indirectly with financial institutions aside from their own bank; correspondent banks and money service businesses (MSBs) for example.
- The period of funding projects tends to be longer term, for example in ongoing building projects, which may require numerous transactions.
- The focus is likely to be broad or even vague in scope and likely to be on minority interests or on those of a specific group and more likely to pursue operations/ projects overseas.
- The popularity of the organisation tends to be limited to a particular sector of society.
- These organisations tend to be more volatile, uncertain, complex and ambiguous.
- The charities are more likely to have numerous bank accounts and/or bank with numerous banks.
- The charity perceives the relationship as confrontational with little or no dialogue with the bank.
- The charities are more likely to be medium/major in size.

Participants may describe the potential for risk both to themselves and to the bank, acknowledging that there was an enhanced risk of contravening CTF regulation, by transferring funds to politically unstable areas. Some of these funds transfers were affected through Money Service Businesses (MSBs).

As discussed previously, the vulnerabilities associated with MSBs and the assessment of high TF risk associated with them has had a significant impact on the attitude of banks. As a consequence of bank de-risking leading to MSB account closures, vulnerable groups in society have ultimately been affected.²⁶

²⁶ Chapter Three s. 5.2 and Chapter 5 s. 5.2.1.

A participant from an MSB considered that the reputation for risk within MSBs in general was undeserved and reiterated the negative consequences of account closures:

They can manage the risk with robust controls and due diligence procedures, but if a bank decides to close the bank account of an MSB, they just go ahead and do it - and this has happened on numerous occasions. This can have huge repercussions for the business; they just can't operate, and it leaves many people without any banking facilities. Families rely on remittances for example from the UK to places like the Sudan, and if an MSB is closed down this means vulnerable people are suffering. (Interview 32)

A charity regularly transferred funds overseas through the Money Service Business (MSB) Western Union. The participant believed that, as the due diligence was done by the MSB, this should not have unduly concerned the bank. This proved not to be the case, and a huge volume of enquiries ensued with respect to these transactions, which took three to four weeks of work to respond to, dealing solely with the information they were asking for. (Interview 15)

Other participants reported regularly using the services of the two largest MSBs, Western Union and MoneyGram, also experienced problems with their bank in this regard. (Interviews 13 and 14) if such problems become insurmountable this could result in charities withdrawing aid from certain regions.

Several participant organisations in this group had been threatened with closure of their accounts, actually had their accounts closed, or had encountered other serious problems in the relationship with their bank. An umbrella body confirmed that this was not uncommon, but some charities were less able to cope with the sudden closure of their account. A particularly difficult situation arose when a charity only had one account:

I have had probably a handful of charities that I've dealt with that have had one bank account that has been closed, and they literally have been operating without a bank account. (Interview 4)

Another medium-sized charity described the problems they encountered when faced with this possible scenario:

Our bank threatened to close our account, and it was a lot of work trying to persuade them not to, which eventually we did. Once that has happened you are always on tenterhooks that it might happen again, and we use a lot of resources providing information that they ask for, even if it appears totally pointless, it is vital that we keep our bank accounts open. (Interview 14)

The charity was threatened with bank account closure at short notice, with no explanation for the decision and no opportunity for dialogue prior to the decision being made:

They had just taken the decision without even asking us for our point of view. They were quite draconian. They didn't seem to appreciate that by giving us 30 days' notice that they were going to close our account, we couldn't just open another account because it takes between 3 to 4 months... There seems to be no leniency at all in their methodology. (Interview 15)

Although in this instance the charity managed to retain its account, there have been numerous well-publicised cases of charities having bank accounts closed in recent years, as illustrated below. However, the scale of the problem in the UK is unclear.

The international aid charity the Ummah Welfare Trust received notice by their bank HSBC in July 2014 that they would be closing several of their accounts, effectively giving them two months in which to make alternative banking arrangements. The bank reportedly refused to comment on the decision other than stating that it was based on the conclusion that the charity's activities were outside the banks 'risk appetite.' The charity received an income of £16 million in the financial year to 2012, and supported causes in many countries, including providing humanitarian aid to Gaza. Trustees believed that the decision was directly connected to its operations in Gaza, as Barclays had similarly closed accounts when the charity began its humanitarian support during the Gaza conflict in 2008. It was believed that the subsequent refusal of banks such as

Lloyds TSB, NatWest and RBS to open accounts for the charity was due to the action taken by HSBC.²⁷

Upendo UK, a charity providing humanitarian aid to Kenyan orphans also had its bank services withdrawn, without prior warning, by HSBC. The first indication that this had happened came when a donor reported to the charity that their payment had been rejected; it was then discovered that the account had been closed. The matter was taken up by *The Observer* newspaper, and the account was reportedly reinstated; the charity was then left trying to recover £2000 of cancelled standing orders.²⁸

Although both aforementioned cases involved HSBC, there are many examples of other major banks de-risking in this manner. According to one participant, the problem of bank closures may be far more extensive than the publicised cases indicate, as many charities would not wish to publicize the fact that they had their bank account closed, fearing this may affect their relationship with other banks, as the above example implies. (Interview 7)

This was also seen as a potential means of tarnishing the reputation of a charity. Muslim charities may feel particularly vulnerable to adverse publicity. Self-styled think tanks may pick up on adverse publicity derived from account closures and infer wrongdoing on the part of a charity that is completely unfounded. This insinuation of wrongdoing can inflict significant reputational damage. Even links with other charities that have been tarnished in this way may give sufficient cause for a bank to refuse to offer their services to the charity. (Interview 7) This view was also shared by participants from umbrella bodies, recognising that Muslim charities may be particularly affected by publicity in this regard. (Interviews 4 and 25)

²⁷ Kirsty Wheatley, 'HSBC to Close Bank Account of Charity Working in Gaza' (*Civil Society News*, 25 July 2014) <https://www.civilsociety.co.uk/news/hsbc-to-close-bank-account-of-muslim-charity-working-in-gaza.html> accessed 1 March 2020.

²⁸ Anna Tims, 'Banks accused of putting lives at risk as charity accounts are shut without notice' *The Guardian* (London, 8 May 2017) <https://www.theguardian.com/money/2017/may/08/banks-charity-accounts-shut-without-notice-money-laundering> accessed 1 March 2020.

For some smaller charities they may simply not have the resources to counter this negative publicity, and for the larger charities this may be a costly diversion of resources, but an essential expenditure to ensure they are ready to counter attacks on their reputation both swiftly and robustly in the future.

Further problems may arise when a bank closes a charity's account, if that bank is also a correspondent bank on which the charity may rely to transfer or receive funds overseas. As discussed previously, correspondent banks may provide opportunities for terrorist exploitation and have also been assessed as risky for retail banks, due to the complex relationships involved, often international in nature.²⁹ A bank may have access to a whole array of correspondent banks within a geographical area, thus loss of access could make operations for charities within that area very difficult, if not impossible, without resorting to less secure means of transferring funds.

Ultimately the banks in the system are preventing funds going to certain countries... Often the sender is willing to send, and the receiver to receive, but it is the guys in the middle (the banks) who are causing the havoc... (Major international humanitarian charity-Interview 7)

The constraints on the movement of funds for some charities, together with their inability to meet due diligence requirements of their bank, or correspondent bank, may mean that a specific project for which a donor base has provided funds can no longer be delivered. They may then have to rely on another organisation to deliver the project for them.

There were also several examples of 'unreasonable requests for information' cited by the participants, for example:

...details of transactions with Western Union and then list all the directors with their names, date of birth, residency and then they ask silly questions like 'where do they pay their taxes?' ...It's not a question you would ask any of your trustees. (Interview 15)

²⁹ Chapter Three s.5.1: Chapter Four s.5.2.3.

In contrast to the previous group, some of the charities in this category had made some effort to establish a relationship with their bank, but this had only been attempted once there had been a breakdown in communication or a serious threat to the offering of banking services:

In my response to the bank it was very much along the lines that I would very much value a customer relationship so that they can actually get to know us, and we can get to know them, so they can understand the business and there would be a lot of benefit on both sides of actually understanding exactly what we do...they ignored it. (Interview 15)

By ignoring his communication, the participant concluded that the bank had no desire to understand their position.

Another participant described unreasonable requests relating to currency transactions; repeated requests for similar information often by different departments. There were other additional requests, which signalled a lack of understanding of how the charity worked and the nature of the information that was possible to produce. As a 'one off' a project worker on one of their programmes was sent out with a 'significant amount of cash'. (Interview 13)

From the banks' perspective, however, there was also a lack of communication when charities were not complying with their requirements and, in some cases, the bank had been given no indication why this may be. Communication therefore for both parties appears to be problematic. A participant from a large international bank considered it is preferable to have too much, rather than too little information passing from client to bank:

Things go pear-shaped when a business stops communicating with the bank. Inundate them with information demonstrating that you have rigorous accounting policies in situ. What banks hate is surprises. (Interview 34)

Although banks may be more concerned with the relationship from the commercial aspect, communication is often a key determinant to maintaining a good relationship.

A lack of understanding between charities and banks of the business of each other was also evident. A participant compliance officer from an international bank recognised the desirability of understanding the business of their clients:

Well that is something that they have to do when it comes to their charity clients, but whether it is something that they do very well, is a different story. (Interview 17)

An umbrella body participant expressed some sympathy with the banks, acknowledging that they have their own due diligence to undertake, but considered that they did not endeavour to understand the particular problems of charities operating in difficult circumstances. (Interview 25)

Banks would not treat the fact of registration with the Charity Commission as a kite mark of quality; charities need to take positive steps themselves to reassure their commercial partners that they are managing their own risk. Keatinge, in his report on bank de-risking, concluded that many charities regarded their bank account as a utility in the same way they would any other, and approached the bank only if there was an issue or complaint.³⁰ Most of the study participants in this group had viewed the poor relationship with the bank as the fault of the bank, for which various reasons were given. Only one, as identified above, had mentioned mutual understanding as beneficial in a banking relationship.

There should be some responsibility taken by charities to establish a good relationship with their bank, and to work in partnership. The next two categories of charities have managed to do this to some extent.

Many charities, especially the larger ones, have numerous accounts on the basis that if one were to be closed, they would have others to fall back on. 300-400 accounts would not be uncommon for a large charity. However, from the banks' position they may prefer their clients to bank exclusively with them, so that they

³⁰ Keatinge (22) 84.

would have the full picture of the transactions flowing through the accounts. In carrying out their risk assessment on the charity the more information they have in their possession, the more sophisticated the picture, and the more nuanced their position will be on risk.

...if they only see segments of your activities and maybe the accounts you use them for are the ones you only do work overseas with high risk entities, then clearly, they feel less comfortable about that. (Umbrella body- Interview 4)

In the US, Eckert also noted that a high proportion of NPOs had operating revenues of less than \$1.5 million; small in comparison to the bank's corporate clients, and consequently less profitable. In an effort to minimize the effect of possible account closures some were making the decision to operate several accounts which had the potential effect of providing even less profitability for banks.³¹

Loss of banking services can have severe consequences from a reputational perspective, affecting donor confidence. According to a specialist umbrella body the effect on reputation is clear:

...that's undoubtedly a huge reputational black mark if you lose your bank account. (Interview 4)

There is empirical evidence to support this, suggesting that the reputation of a charity has a significant effect on the ability of that organisation to attract donors.³²

A charity may assess the risk of having an account closed and decide to take action to mitigate the effect by approaching other financial services providers. If they had already experienced difficulties with their bank, this may become known to any potential provider, who in turn may consider this information when assessing the risk to them from this potential new client. There is some

³¹ Sue Eckert, 'Financial Access for US Nonprofits' (Charity and Security Network, February 2017) ch 6.

³² May-May Meijer, 'The Effects of Charity Behaviour on Charitable Giving' (2009) 12 Corporate Reputation Review 33.

evidence that charities fear publicising the challenges they face, as they anticipate stigmatisation, which may lead to greater financial restrictions. As a consequence, the problem may be underestimated.³³

Several international bodies, including the FATF have in recent years recognised that the consequence of banks de-risking could lead to less transparent modes of financial transaction, and even financial exclusion, with a consequent increased risk of abuse. US NPOs for example reported being compelled to move money by alternative means when wire transfers became unavailable to them, including the use of cash.³⁴

The situation has arisen, according to the former chair of the Federal Deposit Insurance Corporation, in which 'we have moved from a system that was designed to track the movement of money, to a system that is forcing the money out of the legitimate banking system and into the shadows where it is almost impossible to track it'.³⁵

Financial access for US international NPOs (INPOs) has been the subject of a recent study (February 2017) concluding that the problem for International NPOs is systemic. 75% of those surveyed experienced banking problems, with delays in transferring funds by means of wire transfers affecting 37% of these. Other problems included increased fees and unusual documentation requests, affecting 33% and 26 % respectively. 10% had been denied bank accounts and 6% having bank services terminated, often with no explanation.³⁶

NPOs reported having problems transferring funds to all international destinations, not just to conflict zones or failing states, though unsurprisingly working in areas such as peace building, public health, human rights and humanitarian relief appeared more problematic.³⁷

³³ Keatinge (n 22) 41.

³⁴ Eckert (n 31) Executive Summary vi.

³⁵ Bill Isaac quoted in Charity and Security Network blog on de-risking (C&SN 5 November 2015).

³⁶ Eckert (n 34).

³⁷ *ibid.*

The scale of the problem in the UK is unclear. Artingstall et al were unable to ascertain the extent of account closures, or changes in the behaviour of charities with respect to the area in which they operated due to difficult banking relationships.³⁸ The Charities Aid Foundation (CAF) has endeavoured to establish how many charities have been denied access to financial services but has been unsuccessful.³⁹ Reuters reported that in the two years to 2017 the level of actual bank account closures of UK-based charities was in the region of 300, with thousands more experiencing other forms of disruption to banking transactions.⁴⁰

Closures of accounts, delays and problems in transferring funds have a direct impact on the ability of NPOs to carry out humanitarian work. If formal banking channels are closed to them, alternative methods of ensuring funds can reach their destination have to be explored, which often involves additional expense and less accountable methods of moving and storing funds. As outlined in Chapter Two, informal methods of transferring funds, for example Hawala and the use of cash couriers, are less traceable and more open to abuse by terrorists.⁴¹

According to the 2017 National Risk Assessment (NRA) the terrorist financing risk category associated with cash couriering is high. In the UK this method is used to transfer funds to areas where foreign fighters operate, Syria for example. The extent of use of cash for terrorist financing purposes is virtually impossible to assess due to the widespread use of this payment method for legitimate purposes. According to the NRA, the use of cash is declining, and this trend is projected to continue. This remains, however, the most popular method of payment in the UK.⁴² Cash can be taken out of the country by numerous

³⁸ Artingstall and others (n 10) 59.

³⁹ Tims (n 28).

⁴⁰ Lawrence White, 'Three Hundred UK Charities Hit by Global Crackdown on Illegal Funds' (*Reuters*, 27 July 2017) <https://uk.reuters.com/article/uk-banks-charities/three-hundred-uk-charities-hit-by-global-crackdown-on-illegal-funds-idUKKBN1AC0F3> accessed 1 March 2020.

⁴¹ Keatinge and Keen (n 12).

⁴² HM Treasury/Home Office, *National Risk Assessment for Money Laundering and Terrorist Financing* (October 2015 and 2017) 65.

individuals and smuggled into the recipient country with relative ease, or across borders of neighbouring countries in areas where the economy is cash-based. In such circumstances the movement of relatively large sums of money may attract less attention.⁴³

The Charity Commission has also issued guidance in relation to the use of cash and its attendant dangers, which apart from the danger of interception by terrorists, includes the risk of confiscation at the UK border.⁴⁴ For some charities, however, there is no alternative. Again, there is no way of gauging the extent of cash couriering. Participants have described incidences where funds have been taken to eventual beneficiaries by this means (for example, Interviews 6 and 13.) According to several umbrella groups, however, this is not common practice:

International charities are aware that this should be a last resort, and none would use this means of transferring funds if there was an alternative. (Interview 25)

Some charities do use these entities, such as hawalas, MSBs and cash couriers to transfer money but there really is no appetite for that... charities don't do that because they want to avoid the banking system. Every charity, if you give them an option would say "I want a normal bank account, banking relationships with formal established banks and transfer my money that way." That's what they would all want. (Interview 4)

Another potential area of conflict between charity and bank relates to the high-risk transactions when operations are carried out in countries with sanction regimes in place. Financial sanctions, as discussed in previous chapters, may take the form of asset freezes or restrictions on financial markets.⁴⁵ An example of this would be a restriction on making financial transfers to certain countries, and this would include carrying cash into the country. Financial sanctions may also involve a direction being issued to cease a particular business or activity or to cease business with a certain individual or organisation subject to sanctions.⁴⁶

⁴³ *ibid* 67.

⁴⁴ Charity Commission, Regulatory Alert 'Regulator Warns Charities Against the use of Cash Couriers' (Regulatory Alert, 24 February 2017).

⁴⁵ For example, Chapter Three s.3.1: Chapter Four s.4.1.

⁴⁶ HM Treasury/ OFSI, 'Financial Sanctions Guidance' (March 2018).

Charities may apply for a license to carry out a certain activity allowing them to work with a sanctioned organisation or an individual. Participants reported difficulties with the bank when licenses had been granted, with banks in the system preventing funds either indirectly or directly from going to certain countries, sometimes due to the requirements for information from the charity in order to process the transaction.

A participant described the banks' position with respect to the sanction regime:

What we have increasingly seen in the sector, you've got this unofficial regulator that is almost stifling those projects through its control. (Interview 7)

Overall the bank participants summarised their position as being under commercial pressure to manage the risk their clients presented, which often resulted in smaller charities being excluded.

What you have is the perfect storm and, as only the banks can, they manage to over-bureaucratise, which meant that account opening has just become so onerous and so difficult that the unforeseen consequence, for the likes of charities is they have been squeezed. (Interview 34)

Another bank participant also held the view that small charities as a commercial consideration were often more trouble than they are worth:

They have other clients who don't require much contact and are far more lucrative for the bank. (Interview 33)

The key to maintaining a successful banking relationship was good communication, according to all the participants representing financial services businesses (Interviews 17, 32, 33 and 34) and which was more likely to be poor in the first two groups discussed, in contrast to the relationships fostered by both parties in the groups in the following two categories.

Although the charities in this group struggled with their banking relationships there are possible alternatives which could be explored. Metro Bank for example operate with a simpler account-opening process and other banks such as Handelsbanken operate at a more local level and their business model involves rooting themselves within the communities they serve. TSB have also introduced an element of local decision-making whereby they could have some discretion as to which charities and businesses they support. (Interview34)

The idea that HSBC or NatWest are going to do that any time soon is unlikely, as banking systems are now so centralised...What they can or can't do at branch level is negligible. It's like the store manager of Tesco's, they don't have any discretion as to the price of bread. Handelsbanken though, it hasn't (been centralised) and it's really interesting that Handelsbanken has really targeted small businesses across the UK on a really local level and have been incredibly successful. (Interview 34)

There was a sense of frustration, as with the previous group, that charities were faced with unreasonable requests for information which diverted valuable resources away from their core function. The problems associated with bank account closures or the threat of this action were however in greater evidence within this group, which could be particularly damaging from both a reputational perspective and practical level. Further challenges for this group have been highlighted with respect to banking relationships for those relying on MSBs to transfer funds. As highlighted on Chapter Four, the interpretation and implementation of CTF regulation has had far-reaching effects, impacting on charities in an indirect manner due to the perceived risk that potentially both charities and MSBs may present, and the nervousness with which banks now approach any relationship which may expose them to enhanced risk.

5.3 Collaborative relationship/low banking requirements

The characteristics of this group are likely to be as follows:

- Use of banking services are at a low or moderate level in terms of value, and the transactions are at a low level of complexity (although there may

be occasional overseas transactions) and would tend to be transparent, stable and uniform.

- There are more likely to be well defined and fairly stable funding streams, for example government grants. The projects they fund are likely to be straightforward.
- The focus is likely to be narrow and possibly limited geographically with a domestic rather than international focus. Campaigns have a high profile locally, possibly spearheaded by local celebrities and brand/reputation is of great importance to the charity.
- The popularity is likely to be broad.
- The operations of the charity transparent and constant and the management structure within the organisation stable.
- The charity is likely to be larger than the first group, being medium to large in size.
- The relationship with the bank can be characterised as a partnership and thus pursued and nurtured for mutual benefit.
- This charity/bank relationship is pursued at a local level, possibly involving a relationship manager, or other individual taking an interest in the charity.

Although this group had the largest number of charities fitting the characteristics, participants from five medium-large domestic charities reported no known friction between their charity and their bank. The trustees had heard no negative comments from management in this regard, thus concluding that the banking provision was adequate and met their requirements, rather than outlining a positive working partnership. There had been no incidents involving confrontation with the bank reported to the participants in this group, hence the inclusion of these entities in this category and not the first. The charities were limited geographically although one was under a national umbrella. None had large sums flowing through their account; neither did they require complicated transactions that may cause concern to their bank. (Interviews 1, 2, 3, 5 and 10)

The other participants in the group were satisfied with their banking relationships and to some degree portrayed a good working partnership.

A large charity regularly sent funds to countries where, as the participant trustee acknowledged, there was known terrorist activity. They had not, to his knowledge encountered any delays in transferring funds, unusual document requests or any problems with respect to the charity's banking relationships.

I'm not sure whether it's because we have strong links with people in financial institutions (donors who have responsible positions within large London-based UK banks) or because we are involved in education and not aid... We also go to a lot of detail as to where the money is going because we're looking at fraud, which could also apply to terrorist financing... so I'm pretty confident that we're doing all that we can, forensic audits do that especially well. (Interview 16)

The participant cited the personal relationship between the trustees and individuals in the bank, which would possibly enable them to understand and respond to requests for information in a timely manner. This would possibly obviate the need for more extensive and repetitive requests for information that characterised the relationship that had developed within the previous two groups.

Although this charity operated overseas, the fund-raising took place at a relatively local level and the brand and reputation of the charity was maintained by high profile local campaigns. For many charities of this type the ability to engage with the local population and in some cases local celebrities is a critical element of their domestic brand image. This engagement may extend to their appointed relationship manager, whose presence is notably absent in the previous groups' banking relationships. This representative may be invited to attend local fund-raising events and thus foster a good relationship between the two organisations. This may enable the bank's representative to develop an understanding of the charities mission, and for the charity to have access to the bank to alert them to any issues that may arise before any misunderstanding has the chance to develop, and for them in turn to better understand the position of the bank.

A participant compliance officer from a bank acknowledged that there was no financial incentive to the bank to offer their services to a charity when, from a commercial position, the charity may not be very profitable, however:

I think the incentive for the bank to deal with the charity comes from an ethical and reputational standpoint. (Interview 17)

In this respect the bank may therefore choose in which charities it would be worth investing its time and resources. This is more likely to be a charity they perceive to be good for their image, but also one in which there has been commitment from the charity to the relationship.

Some charities reported banking with specialist charity and social banks, for example Charity Bank. These however are backed by mainstream banks and equally have to operate within their own defined risk appetite. In the event the backing mainstream bank changed its risk profile, the social bank would not be empowered to make a decision to retain a charity client on the basis of their charitable mission or for other non-commercial reasons that may nonetheless have ethical merit.

A participant banking with a charity bank considered that, because they deal with charities, they had a better understanding; fewer clients and clients who mattered more to them. He was very impressed with the way the bank dealt with a technical issue with online banking on a Friday afternoon, when he had to get some critical payments through:

They set up to do it manually, they had a team there, who I was talking to at 18.00, who were reading the transactions to me and I was authorizing them verbally and ticking them off...someone was signing them and passing them over to somebody else taking them off to somebody else to input them, so there was a fair amount of effort put in ...I suspect we would not have got the same response from Barclays or HSBC or the Co-op bank. They would probably say "our system is not working, tough, come back on Monday morning." (Interview 18)

This demonstrates a good working relationship between the two organisations.

Other banks don't have the understanding, and they obviously don't want the business either... (Interview 18)

The charities in this group were more likely to have just one bank account, or to bank with just one bank as they were satisfied with the service they were offered, and their banking requirements were not extensive. However, some charities were considering opening another account for technological security purposes.

If you think about the TSB fiasco, and how much trouble that has caused, it makes you think. But if that was your only account how much of a problem would that be? (Interview 20)

The participants in this group either had a satisfactory relationship with their bank or enjoyed a more collaborative relationship than the previous two groups, which appeared to be mutually beneficial to some extent. For some, their choice of banking with a specialist charity bank was key, but for others effective communication was evident, which was absent from the two preceding groups, resulting in a collaborative relationship and good working partnership with their bank.

5.4 Collaborative relationship/high banking requirements

This group is made up of organisations that have a more complex requirement for financial services than the previous category but have an equally or possibly more collaborative and mutually beneficial relationship with their financial services providers.

The charities in this group are likely to have the following characteristics:

- The use of banking services is high both in terms of overall value, and in the complexity of the transactions.
- Well-defined funding streams, for example, from large government grants and other major sources such as retail outlets selling donated items and a wide range of new branded items. Other sources may include

donations from organisations, funds raised from national events and from bequests.

- The focus is likely to be clear and contained in scope with little or no evidence of mission creep.
- Campaigns have a high profile both nationally and possibly internationally which may be promoted by means of media advertising campaigns and celebrity endorsement. Brand and reputation are of great importance to the charity.
- A clear, well-defined and publicised strategy, and potentially integrate into government policy, for example health policy, and work closely with government bodies to align resources in specific areas (endorsing the government's policy message.)
- Possibly partnering and integrating into well-respected international bodies such as the UN.
- The relationship with financial institutions is one of partnership.

A major national charity participant within this category described his organisation's banking requirements as significant and had accounts with two major banks. This arrangement had worked very well from the charity's perspective as their requirements had been met, and his view of the bank's perspective was:

We are very much in demand as a customer, so our two main banks have a significant role particularly in the retail chain and they want to hold on to us as customers, and other banks would dearly love to have us as customers. (Interview 26)

He acknowledged however that other organisations within the sector might not have the capability or expertise to maintain effective collaborative relationships:

Like anything, the charity sector is not perfect, it doesn't always have the right mechanisms and dynamics to improve in the same way as the commercial sector has that dynamic... (Interview 26)

The large organisations that are run as a business are possibly more likely to have the expertise required and to recognise the benefit of establishing effective working relationships with their suppliers. Even large organisations that regard the service of banks as a commodity need to establish and maintain relationships whereby both parties regard their investment in the relationship as equally rewarding.

A participant from the banking sector outlined the preferred business model from a bank's perspective:

There are two types of client; at one end you have 'high touch' which is lots of interaction on a personalised level, and on the other you have low touch which is no interaction as it is all remotely configured. Clients can also be low or high value to the bank. So, a business model that requires high touch with low value is undesirable. What banks try to do then, is have high value customers with low touch so that's going to make you lots of money. (Interview 34)

It is in this latter category that this group of organisations is more likely to fall.

In the strategic and consultative relationship both organisations invest to a comparative degree in the terms of the relationship and both see the value of this relationship. If, for example, the charity did not perceive the value offered by the bank as acceptable, they could switch banks. This dissatisfaction could be due to a number of reasons, for example, the rate of interest offered on the accounts, level of charges for services, range of services or quality of the service provided, or some perceived benefit provided elsewhere. Similarly, if the bank did not perceive the relationship as beneficial it could cease supplying these services.

The other charities classified in this group were also major in size but with a more pronounced international reach. One participant trustee of a charity operating in 35 different countries had received no reports of difficulties with transferring funds, or any other points of friction that could have been attributed to the bank:

We have had problems yes, and there have been delays but that is a separate thing from the banks walking away from us and refusing to deal with us... the delays weren't caused by the banks putting obstacles in our way. (Interview 27)

Another participant represented a charity that acted as an intermediary to which government grants are regularly awarded and the charity pays another partner body to deliver the service. The charity may also receive grants from other governments, potentially complicating the picture further. However, despite these and other complex and potentially high-risk transactions made to areas of political instability, there had been no reported delays or other difficulties in transmitting funds to the partner or eventual beneficiaries. (Interview 28)

Entities in this category are more likely to offer banks their preferred low touch, high value business model. The reputation of the charity may not be a significant consideration either in this relationship, as one banking participant suggested:

The whole thing about banking is that it is entirely unemotional...banks have the lowest NPS scores of any industry.⁴⁷ So, the idea that by association banks can undo the pretty lousy service... with associating with good causes-well that won't work, it won't make the slightest bit of difference. (Interview 34)

Large banks do however generally have a corporate responsibility policy through which they contribute to the wider society. The contributions may however not be widely advertised for fear of further alienating their customers, already disgruntled about poor returns on their investments and poor service from their bank. They may also have a dedicated department dealing with charity customers. As far as commercial decisions are concerned though:

The thing to emphasise is that banks have no ethics or morals. If you take a client on and they are seen as money laundering that is a £3 million fine. It is entirely about the downside of what fines the

⁴⁷ Net Promoter Score, the gauge of propensity to recommend services, goods or a company, for example, thus a measure of the loyalty of the relationship a customer has to an organisation.

government will be imposing on them. It is not really a moral judgement; the commercial judgement is born out of the likelihood of government intervention and the fines which may be levied. (Interview 34)

The charity participants within this group have high banking requirements but enjoy a good working relationship with their service providers, unlike the second group. This may be because these charities have the expertise to cooperate with requirements of the banks, for example, for information, which in turn may satisfy their due diligence requirements. Banks can therefore be seen to comply with the regulations as well as managing their risk. If transactions by charities within this group were considered 'high risk' the bank may nevertheless be willing to work with the charity to manage the risk as the continuing relationship with the charity may be justified from a commercial perspective, in a way that a charity from the third group may not be.

6. CONCLUSION

The CTF regulatory framework has directly affected the operations of banks. The spiralling cost of regulatory compliance, for example, and the consequences of unintended regulatory breach have meant that risk management is now a very real concern and one that is central to their relationships with clients. This impacts on their willingness to offer services to organisations they may perceive as higher risk. In the analysis of the data, it is apparent that matters of regulatory compliance that directly affect financial institutions may have an indirect effect on charities.

There has been a variation of the impact the 'ideal types' identified have experienced. The data analysis reveals that many charities experience problems accessing banking services. Some have been threatened with account closures or had accounts closed, and the attendant adverse publicity and reputational damage may be significant. The analysis of interview responses also suggests that Muslim charities particularly may be affected by adverse publicity in this regard. Organisations operating in countries subject to sanction regimes

encountered difficulties as banks prevented funds either directly or indirectly passing through regulated channels, thus curtailing charitable activity.

Further indirect effects on charities of the CTF regulation derive from severance of banking relationships with correspondent banks and the risk associated with MSBs, which may constrain the movement of funds for charities and impact on the ability of charities to operate, and possibly lead to less transparent modes of storing and transferring funds.

Banks often make requests for information which appear irrelevant, repetitive and time consuming to complete, and the effort involved for charities may be unacknowledged. There may be very little contact with the bank, although some would welcome a greater level of engagement than the bank is willing to provide. There appears to be a lack of understanding and awareness, especially in the first two groups discussed, by all parties, of the working environment in which the other operates. Lack of communication is a common theme within these groups, which causes uncertainty and may elicit greater caution from the banks as a consequence. Other factors potentially influencing these relationships, explored in this chapter, may be within the control of the charities themselves. For example, demonstrating a level of scrutiny of source of funds, due diligence applied to distribution of funds and the transparency of the audit trail can also provide reassurance to financial partners.

Where relationships were collaborative, as characterised by the second two groups, there were fewer examples of dissatisfaction: the charities perhaps more conscious of the banks' requirements, more willing to provide the information and therefore provide the reassurance that greater certainty provides. From the banks' perspective it is preferable to have too much rather than too little information. Where there is a good relationship with the bank though charities have found a genuine willingness to engage with them and to work through any difficulties.

Charities require financial services, and clearly any difficulties in accessing such services may impact on their operating ability. Banks, as commercial enterprises, may have no incentive to continue providing services, and the risks involved may be considered prohibitive. The alternatives for charities though may be significantly more risky, otherwise charities may consider curtailing their own operations and make difficult decisions about which projects they deliver. Thus, finding a way forward to support banks in the provision of services is imperative, in order that charities may continue delivering their services.

CHAPTER 8: THE ENGAGEMENT OF CHARITIES WITH THE REGULATOR

1. INTRODUCTION

The Charity Commission's role with respect to the regulation under review is to consider the international obligations emanating from bodies such as the Financial Action Task Force (FATF) and the UN as discussed earlier,¹ and to make these comprehensible to charities so they understand what is expected of them in terms of compliance, thus facilitating charities' adaptation to the changing legal landscape. The Commission provides guidance, may monitor compliance, carry out investigations and take appropriate action in cases of non-compliance.

The role of the Charity Commission, however, has changed dramatically in recent years. The majority of participants from charities and umbrella groups interviewed commented on this change, which has come about largely due to budget cuts, and the impact this has had on them in terms of access to guidance. Participants viewed the Charity Commission's role as having two distinct functions, advisory and regulatory.

The objective of this chapter is firstly to examine the nature of the participants' engagement with the Charity Commission in its advisory role and secondly, to examine and analyse their responses with respect to the Commission's regulatory role. This addresses the question of how the Regulator may influence charities understanding of, and compliance with the regulation. It is important in understanding the responses to first consider the recent background and context in which the Commission now operates. The chapter will then discuss the accessibility of advice and the perception that charities have, both positive and negative, of the Commission as a source of guidance. Participant responses revealed that all had experienced some degree of engagement with the Charity Commission when seeking advice. After initial contact, in some instances, this

¹ Chapter Four ss.4-5.

advice was sought from, and provided by, other third parties. This alternative means by which advice is filtered is discussed in the final part of this section.

The second part of the chapter focuses on the regulatory role, and the interaction between the Regulator and individual charities from the perspective of both charities and umbrella bodies who represent them. The experience of the Regulator from the end-user perspective is discussed with reference to the interview data. The analysis commences with a discussion of how the Charity Commission conducts its business. In contrast to this, the themes identified in the analysis of the interview data are discussed with reference to how participants perceive that the Commission *should* be operating; the perceived appropriate role for the Regulator.

Matters of concern to some participants which affected their relationship with the Charity Commission, for example, political neutrality and unfair targeting of Muslim charities were identified. Other matters concerned a wider range of participants, for example, who should champion the sector? The duality of role and potential for conflict of organisational objectives, and who the Charity Commission *should* be regulating is also explored. Finally, some of the wider issues such as the involvement of other third parties and matters of accountability will be discussed from the perspective of the charity participants, as well as the contentious issue of who should pay for the Regulator.

2. RECENT BACKGROUND AND CONTEXT

A review of the legal basis of charity law and practice by Lord Hodgson (the Hodgson report), published in 2012, considered fundamental matters such as public benefit and charitable purpose.² Recommendations were also made regarding the status and function of the Charity Commission, the threshold for registration of charities, the role of trustees with respect to decision-making and funding the Regulator. The report, amongst its recommendations

² Minister for the Cabinet Office, 'Trusted and Independent: Giving charity back to charities: Review of the Charities Act 2006' (The Hodgson Report) July 2012.

numbering over 100, concluded that there should be greater emphasis on trustee responsibility, for example to meet the public benefit requirement with respect to their charity, and generally to have wider scope to make judgments, without being restrained by undue bureaucratic processes.³ Furthermore, it was recognised that the Regulator needed to be adequately funded, and proposals were made for charging charities for some services: no far-reaching proposals were forthcoming in this regard. There was recognition though, that an analysis of financial efficiency was required.⁴

The Commission, in its 2011 report, announced its intention to concentrate its resources on developing compliance and accountability and the self-reliance of the sector.⁵ The provision of advice, recognised as being outside its core regulatory role, was now viewed as non-essential; as such the focus would move away from this aspect of the Commission's work.⁶ In recognising too, the need to take a risk-based approach to its work, based on proportionality, the Commission was also factoring in the reduced level of funding it received in the financial year to 2012: a trend projected to continue. According to the Hodgson report the Commission's new focus accommodated the requirements of the Charities Act 2006, as well as the decline in budget.⁷

In 2013, ahead of the government spending review, William Shawcross, then chair of the Commission warned that if a budget cut of even ten percent were to be imposed; maintaining the core function of regulating the sector would be at risk.⁸ The budget cuts have been sizeable since 2008, falling by £8 million since 2010 and prompting discussions, currently ongoing, amongst stakeholders and government on whether charities should be charged for the Commission's

³ Jonathan Burchfield, 'The Hodgson Report Revealed' (Charity Financials 20 July 2012) <https://www.charityfinancials.com/charity-financials-insider/the-hodgson-report-revealed-1156.html> accessed 13 September 2019.

⁴ The Hodgson Report (n 2) 125-128.

⁵ The Charity Commission, 'Strategic Plan for 2012-2015' 7 December 2011 1.

⁶ *ibid.*

⁷ The Hodgson Report (n 2) 45.

⁸ Celina Ribeiro, 'Charity Commission Could Not Sustain Cuts of More Than 10%' (*Civil Society*, 20 March 2013) <https://www.civilsociety.co.uk/news/charity-commission-could-not-sustain-cuts-of-beyond-10-per-cent.html> accessed 1 March 2020.

services.⁹ The government has recently awarded the sum of £5 Million of ‘interim’ money for the Commission to enable it to respond to increased pressure on its services, primarily compliance and the registration of charities. This figure amounts to a substantial boost in income, which has typically been around £20 million per year, but this annual figure represents only half the figure in real terms received ten years ago.¹⁰

The rise in demand for the services has been unprecedented, according to the Charity Commission’s 2018 annual report, both in terms of new registrations and in the number of compliance issues demanding action.¹¹ The increase in applications for registration over the past five years has been around 40 percent, with the year to 2018 recording the highest level to date.¹² The new regulatory powers introduced by the Charities (Protection and Social Investment) Act 2016 (the Charities Act 2016) have also expanded the Charity Commission’s workload. These powers, which include the disqualification of individuals and issuing of official warnings, were used on 78 occasions in the reporting period to 2018.¹³

The Charity Commission faced criticism in the past for its limited ability to address the problem of terrorist fundraising within charities, and to challenge and disqualify trustees associated with terrorism.¹⁴ Its failure to prove allegations against the charity Interpal with respect to its alleged funding of Hamas has also been attributed to a lack of resources which would be required for such a complex case.¹⁵

⁹ Charities Aid Foundation, ‘Funding the Charity Commission: To fee or not to fee? That is the question’ (Discussion paper, January 2018)

¹⁰ Kirsty Weakley, ‘Government gives Charity Commission an extra £5 billion per year in funding’ (*Civil Society*, 22 January 2018) <https://www.civilsociety.co.uk/news/government-gives-charity-commission-extra-5m.html> accessed 1 March 2020.

¹¹ Charity Commission, ‘Annual Report and Accounts 2017-2018’ (Report to Parliament 2018) HC 1211

¹² *ibid* 3.

¹³ *ibid* 9.

¹⁴ The Henry Jackson Society, Written Evidence submitted to the Home Affairs Committee ‘Counter-terrorism’ (Reference CTE0015, 9 May 2014) para 23.

¹⁵ *ibid* paras 24-27.

Walker also casts doubt on the Commission's willingness to tackle allegations of terrorist activity. Although the Commission had opened inquiries into allegations of terrorism within charities, it has been slow to use its powers. He therefore questions whether the resolve to tackle such allegations is sufficiently firm.¹⁶ The Commission's track record in this respect "does not match the seriousness with which the threat of terrorism is depicted in CONTEST."¹⁷

The National Audit Office (NAO) report also raised issues of regulatory ineffectiveness with respect to the handling by the Commission of the charity The Cup Trust.¹⁸ Although terrorist financing was not at issue, this case provides an example of loose and questionable financial control. The Cup trust had one sole corporate trustee, Mountstar, a company registered in the British Virgin Islands. The trust had reportedly set up a complex tax avoidance scheme in which it claimed £46 million in gift aid, whilst donating around £152,000 to charitable causes in the four years to the time of the report. One of the directors was found to have profited in fees/commission in the order of £2 million, which also added to the sense of public outrage.¹⁹

The Charity Commission was criticised for its response, failing to consider whether the Trust met a key legal requirement before registering it as a charity, which was the potential conflict of interest inherent in having a sole corporate trustee. Furthermore, it was found to have adopted an inappropriately passive approach to its investigation which, after two years, resulted in merely issuing regulatory advice to the trustee.²⁰ The chair of the Public Accounts Committee (PAC) Margaret Hodge, in considering the findings, declared the Commission 'not fit for purpose.'²¹

¹⁶ Professor Clive Walker, Written Evidence submitted to the Home Affairs Committee 'Counter-terrorism' (Reference INQ0011, 30 April 2014) 41 para 15.

¹⁷ *ibid* 43 para 19.

¹⁸ National Audit Office, *The Cup Trust* (HC 2013-2014 814).

¹⁹ Kirsty Weakley, 'Man Behind Charity Tax Avoidance Scheme Received at Least £2m' (*Civil Society*, 18 January 2019) <https://www.civilsociety.co.uk/news/man-behind-charity-tax-avoidance-scheme-received-at-least-2m.html> accessed 1 March 2020.

²⁰ NAO (n 18) 6.

²¹ Rajeev Syal, 'Charity Commission "Not Fit for Purpose" Says Margaret Hodge' (*The Guardian*, 4 December 2013) <https://www.theguardian.com/society/2013/dec/04/charity-commission-not-fit-for-purpose-says-hodge> accessed 1 March 2020.

In a separate report the NAO, commissioned by the PAC to investigate the overall effectiveness of the Commission, came to some very damning conclusions. The report recognised the challenging environment in which the Commission was operating; under budgetary constraints whilst servicing a relatively stable number of charities. The reported regulatory failures of the Commission included: failing to make use of its statutory enforcement powers; taking too lenient a stance in the matter of serious regulatory failures and failures in monitoring compliance. This led to the conclusion that the Commission was not regulating charities effectively.²²

The PAC also expressed grave concern in its 2014 report, that it was examining the Charity Commission for the fifth time since 1987, and ‘was not convinced it has the leadership capability to tackle its significant failings and transform its culture’.²³ The NAO later commended the Charity Commission on securing funding from the Treasury to support its programme of transformation in the order of £8 million over three years. Further NAO recommendations included the automation of low risk work, to enable a more targeted allocation of resources to areas identified as carrying a higher risk.²⁴

The focus and culture of the Charity Commission, therefore, has evolved due to a variety of factors including the provisions of the Charities Act 2006, the recommendations arising from the Hodgson report and ensuing discussions/further reports, and the spotlight that was directed on its regulatory activities including the debate as to whether it remained fit for purpose.

²² National Audit Office, *The Regulatory Effectiveness of the Charity Commission* (HC 2013-14, 813).

²³ Committee of Public Accounts, *The Charity Commission* (HC 2013-14, 792).

²⁴ National Audit Office, *Follow-up on the Charity Commission* (HC 2014-15, 908).

3. CHARITIES' ENGAGEMENT WITH THE CHARITY COMMISSION IN ITS ADVISORY CAPACITY

3.1 Previous perceptions of the Charity Commission

According to several participants, the Charity Commission formerly provided a very supportive and individual service to charities seeking advice. Whilst many charities reported their preference for a bespoke service, the Charity Commission is clearly no longer in a position to provide this.

A participant compared the former relationship with the Commission to that of today:

The main job was advising charity trustees and they did a brilliant job...The in-house lawyers would look at individual cases, look at their governing documents, and answer their queries. The trustee would get something in writing backed by a named lawyer, so that was something they could rely on. Now they point you to the website and tell you what to read. You don't get the benefit of a lawyer interpreting it for you to make it easy; all you have is the legal jargon. (Umbrella type body-Interview 11)

A participant CEO from a major international charity also made a comparison with the service previously offered:

You don't get the same sort of service from the Charity Commission that you used to. We had an issue with a major donor and the Charity Commission didn't give us advice over the phone, but they did get back within two weeks with their advice. But it was still a service that was available to you, but that wouldn't be the case now. (Interview 28)

The Charity Commission itself recognises that its core focus has changed, and its advisory role has to be more targeted and risk-based.²⁵ For many charities not considered high risk with respect to terrorist financing, it is only signposting to the various Charity Commission publications that is on offer, including

²⁵ Charity Commission, 'Strategic plan 2012-2018: Giving the Public Confidence in Charities' June 2012 1-2.

regulatory 'alerts' that may or may not be relevant to an individual charity.
(Interview 10)

3.2 The means by which advice is filtered: The Charity Commission or other third parties as advice givers

Participants all reported some initial interaction with the Charity Commission, for example in the registration process (which may have been some years ago.) In the analysis of the data it became apparent that the experience and frequency of interaction with either the Charity Commission or with other advisory bodies when seeking advice was very varied. All participants were aware of the advisory role of the Commission and the existence of at least some of the means of communication of this advice, for example, the Charity Commission website and possibly some of the various publications available to charities. If any participant reported having no engagement with any advice-giving party, they would fall outside the scope of this analysis.

The discussions with participants and subsequent analysis focused on the nature of the engagement with the individual advisory body and not on the complex advice-sourcing strategy of the organisation which may involve the policies and procedures put in place for ongoing long-term advice sourcing. The individual transactions with respect to advice were analysed, rather than any attempt made by the interviewer to explore how individual organisations use, compare and or engage with multiple sources of advice.

3.2.1 Positive experiences of the Charity Commission as a source of advice and guidance

Many participants had a generally positive perception of this particular role. Several reported a minimal requirement for advice, which was satisfied by one or a few contacts. Other participants, particularly from the larger organisations, were regular users of the resources available and also found the advice and guidance satisfactory. The advice sought was either generic in nature

or more specific advice in answer to a particular question or problem. Several participants from the larger charities enjoyed a mutuality beneficial relationship with the Charity Commission.

A trustee from a medium-sized charity, for example, occasionally used the resources to generally update his knowledge. He reported finding the online guidance from the Charity Commission easy to navigate and identifying the information straightforward.

It's all there pretty much... I go and read the standard on that, so it's something that you don't sit down and do an exam on it, but the more experience you get... well you realise you may have missed something out because you didn't know...I had not looked at that compliance that you're talking about before now. (Interview 21)

I find their online resources very helpful. I think they do what they need to do within the resources they have. There is a question as to whether they should have more resources to do more. (Large charity- Interview 9)

Several umbrella groups commented on the advisory publications and were also positive about the content:

I like the Charity Commission guidance generally; I think it's getting better. I think charities feel clearer and actually, when we surveyed charities, they said that. When we asked them how is the charities Commission guidance? Most people that commented said they thought it was clear and it's good. (Interview 4)

The uptake of their use by charities, however, was an issue for another umbrella body.

They issue regular updates obviously - they are very good at that sort of thing and there are publications that they produce... I'm not sure it comes on their (the charities) radar... in their defence they (the Commission) would probably say "we have done what we can, it's now up to the trustees to be aware of what we publicise." (Umbrella body-Interview 12)

Other charities reported receiving timely and detailed individual guidance when it was needed:

We have a good relationship with the Charity Commission; they play an important role. We went through a very difficult situation last year...and I felt we had good support. (Interview 16)

One potential explanation of the involvement by the Commission in this instance may have been that the charity was perceived to be at greater risk, (being a large international charity sending funds to politically instable geographical areas) and therefore requiring a detailed response.

Participants who had personal communications with staff at the Commission either formally, for example, as part of a monitoring exercise, or informally, as a way of gaining knowledge and reassurance, generally appreciated the contact.

Some participants/colleagues of participants had been employed previously by the Charity Commission and were enthusiastic users of the website and online publications. Unsurprisingly they reported having confidence in navigating the multitude of publications and obtaining the relevant guidance from other government sites if necessary. There was also a far greater confidence in the guidance, in so far as it could be relied upon, if followed explicitly.

I would first of all look at the Charity Commission website, I do that before I breathe in the morning. ... whether it's the Terrorism Act, if it affects charities it should be there. You should be able to do what it says on that website and be totally covered by it, because they are the Regulator...and they are so explicit...you would be hard pushed not to get the advice. (Interview 10)

A participant speaking about a fellow trustee in a medium-sized charity described the process of obtaining guidance, and the relationship with the Charity Commission arising from previous experience:

...she has had dealings with them in other charities, so she is very familiar with the workings of the Charity Commission in a general sense, very aware of the resources and how to use them and where to look but also who to contact etc. I would say that (she) would be our port of call when we need guidance. (Interview 3)

Several other trustees reported relying heavily on colleagues if there were particular gaps in their knowledge. Although this was an issue raised more

frequently in relation to financial matters, this also highlights a possible lack of skills in a number of other areas.

A participant from an umbrella body noted the wealth of expertise available within the charity sector which could be shared with the Charity Commission to assist them in providing the guidance required by charities, in order for them to comply with regulation:

... there are a lot of selfless people who are willing to give up a lot of time to the Charity Commission to share their experiences and help them with that, but they also need to take into account of how they can encourage charities to use that expertise. (Interview 4)

Some of the larger charities reportedly did work directly with the Charity Commission on a number of issues, including guidance documents, in order to assist them in this way. (Interview 27) Furthermore, Umbrella bodies often contribute to consultations and may survey their members to gather opinion. (Interview 4) For example, the recent draft guidance 'Charities That are Connected with Non-charitable Organisations.' This was acknowledged to be impractical, confusing and lengthy, having received feedback from various stakeholders to this effect.²⁶

The Charity Commission also recently surveyed charities working internationally (who were also more likely to be at risk from terrorist financing) on the guidance provided. 37% of the respondents had reported not having read any part of the compliance toolkit, with 76% of these not having been aware even of its existence.²⁷ In the participant group overall there appeared to be a high level of awareness that guidance was available, but the responses as to its accessibility and general usage was very variable.

²⁶ Jonathan Plummer, 'More Work Needed on Connected Organisations Guidance, Commission says' (*Third Sector*, 9 August 2018) <https://www.thirdsector.co.uk/work-needed-connected-organisations-guidance-commission-says/governance/article/1490016> accessed 1 March 2020.

²⁷ Krishna Soni, 'Guidance for Charities Working Internationally: You spoke, we Listened' (Charity Commission blog, 5 September 2018) <https://charitycommission.blog.gov.uk/2018/09/05/guidance-for-charities-working-internationally-you-spoke-we-listened/> accessed 1 March 2020.

3.2.2 Negative experiences of the Charity Commission as a source of advice and guidance

The dissatisfaction voiced by many participants appeared to originate from a persistently higher expectation of the service than that which could realistically be given. Although many appeared to understand the budgetary restraints on the Charity Commission, they nevertheless still preferred to receive personalised advice, although this was very difficult to access:

I prefer to phone the Charity Commission if I can, rather than use their website. It's a bit hit and miss if you get through to them, and what I have noticed is, and I have been dealing with them for a long time, is that more recently what they tend to do is just refer you back to the website. I would say, "I've just been on there, that's why I am phoning you!" (Interview 24)

Several participants from small/medium charities, that were not members of an umbrella body, perceived that the Charity Commission was their only potential source of guidance. The lack of availability of specific advice was particularly problematic:

If you are unsure and you don't know what the requirement is, you do need to speak to someone at the Charity Commission...but there is no one there. (Interview 23)

Another participant from a medium-sized charity reported having referred to the Commission, but without success. He had no contact with umbrella groups; neither did he regularly consult other sources of information.

I have looked to the Charity Commission for guidance but could not find what I was looking for, so I don't go there for information... The Charity Commission tends to be more focused on the purpose and objectives of the charity on the one hand and the financial position, like having enough cash in reserves...so as to avoid being in a financially embarrassing position. So, I haven't had any more to do with them. (Interview 1)

Several problems were highlighted during this interview, ranging from lack of understanding by trustees of their responsibilities, to the lack of processes in

place to meet expected standards. In this case the trustees would have benefitted from access to a reliable source of guidance and advice. The unsatisfactory early encounter with the Commission had not prompted him to look elsewhere, but to proceed in ignorance.

Another participant in a similar position, commenting that perhaps they *should* refer to the Commission's publications for guidance with respect to regulatory compliance, but had not done so, being 'too busy fundraising.' They had approached the Commission for specific advice though:

They (the Charity Commission) wouldn't answer my questions...I think they should be signposting us to some quasi-government organisation. I can't go to the solicitor to get advice, it's far too expensive.
(Interview 6)

Although the charity was a member of an umbrella body, the participant was not sure that he would get support from them but had not asked. There therefore appears to be a lack of knowledge as to what realistically the Charity Commission may offer and lack of awareness of other sources of information available. It was also clear that many trustee participants relied on fellow trustees for advice and guidance rather than outside sources. Overreliance on fellow trustees as the principal source of advice was also one of the findings of the recent report into the awareness and effectiveness of trustees, as well as underutilisation of the resources available from umbrella bodies.²⁸

I think the information and lists are a little bit random-they had it grouped under finance and then under governance and then whatever. I didn't find the information very easy to find because there was so much financial advice on there. It wasn't topped and tailed; it's just under the list of publications.
(Interview 5)

Perhaps the level of commitment to locate the required guidance was lacking here, or the expectation to locate the exact information relating to complex

²⁸ Charity Commission, 'Taken on Trust: The awareness and effectiveness of charity trustees in England and Wales' (November 2017).

matters unreasonable. Others though had made very little attempt to familiarise themselves with the information available at all:

I know they're involved in regulation and we don't have much to do with them, or anything really in that respect...I can't say we use them for guidance, we manage between ourselves really. (Interview 2)

This accords with the findings of the Charity Commission, as noted above, that there appeared to be a problem of awareness, with respect to specific publications that may be of benefit to individuals working in the sector.²⁹

Other charities had come to the attention of the Commission due to operations in potentially high-risk environments overseas. Having attended the outreach seminars, one such reported leaving with questions unanswered. He considered that the advice offered was generally aimed at larger charities. As the Commission's published guidance was not used as a source of reference, this participant sought guidance internally. There was a high level of trust amongst the employees and managers within this faith charity, and it was accepted that each was proceeding to the best of their ability with the benefit of their own expertise. (Interview 15) This further illustrates reliance on fellow colleagues within the organisation, which may be ill-advised.

With respect to CTF and financial crime generally, the availability and accessibility of the guidance from the Charity Commission did not resonate with many of the participants. The majority of participants who expressed a preference for either the Charity Commission or an alternative third party as their most trusted source of guidance, preferred the latter. Most of the major/super major charity participants, however, clearly had the means as well as expertise within the organisation to access multiple means of guidance, including that provided by the Charity Commission.

²⁹ Soni (n 27).

Some of these though reported having only nominal contact with the Charity Commission, even two who had formerly been employed there. (Interview 20 and 26)

The size has shrunk to such a degree that you get very little back. The thought that people are meant to be working on third sector relationships, well that relationship is pretty poor now...and there is hardly any advice given if it's not in an information sheet. (Interview 20)

The importance of sending the right message to charities more generally about due diligence was also highlighted, and one which was not necessarily being achieved:

...what they have got to do (the Charity Commission) is make sure that you are really trying to minimise the risk of this happening in the first place, which is by convincing the sector that they have to be much more careful, not just in terms of terrorist financing, but about fraud and that sort of financial crime. I don't think there's enough emphasis on that." (Interview 26)

3.2.3 Alternative means by which advice is filtered

A detailed analysis of the relationship with other bodies lies outside the scope of this research, however, many participants described incidences of engagement with bodies such as accountants, solicitors and umbrella bodies which will be used as a contrast to the incidences of engagement with the Charity Commission above. Many other participants mentioned the generality of the Commission's guidance and the need to find alternative sources. The most frequently cited professional source was their accountant or auditor, and then their solicitor, if there was no other option. (Interviews 13 and 14)

...it is more likely that we would approach a highly specialised lawyer for advice if we need it; we have done that in the past. (Interview 2)

Many participants had mentioned that accountants were a trusted source of advice and guidance, either generally or for specific problems or concerns:

I think accountants always have done (been expected to interpret the advice emanating from the Charity Commission) I think they may be the first port of call...of course accountants are becoming

more than just accountants, they will provide HR facilities, they will provide a whole range of things you wouldn't expect an accountant to do, and they will want to be offering their services to charity clients. (Umbrella body-Interview 12)

Several participants, though particularly from the larger charities had established their own sources of information and advice. Many were members of umbrella bodies and some had been approached by third parties who were in a position to give advice and had established a mutually beneficial relationship with the organization. Thus, they may have found their own advice source, or the provider may have found them.

A participant from an accounting firm specialising in charity clients commented on the volume of guidance documents available on the Commission's website which had, in her experience, caused confusion amongst her clients. However sometimes the clients just needed a little assistance in navigating the system:

I think it is confusing. It's a question of picking pieces out from it, for example the financial controls checklist and we would send it directly to clients or give them a direct link with instructions what to look for- so we would say "go and look at that" or the more detail document that goes behind that. That is a useful one for clients who were just floundering a bit and not going to easily spot that, and don't know quite where to start. (Interview 29)

Some specialist accountants had provided seminars and other opportunities through which information about their services could be disseminated. From the charity's perspective these specialist accountants offer expertise in charity accounts which many small firms do not have, but they also have the capacity to provide more bespoke advice, or at least be able to signpost them to sources of advice, from other bodies.

A charity accountant reported that she no longer contacts the Commission for assistance. Instead the firm has prepared their own information leaflets and gained the expertise in areas such as financial crime and regulation designed to combat this, as it applies to charities. In so doing it is able to offer a more tailored service to their clients. This also enables them to promote their services to the sector more widely. (Interview 29)

The analysis demonstrates that most participants interviewed were aware that the Commission is not able to provide the advisory service that many were formerly familiar with, although a few still had that expectation. Although some were more comfortable than others with using the material and found the engagement with the Regulator to be a positive experience, there appears to be a void in the provision of guidance and advice.

For some this was adequately filled by other professionals with whom they had a relationship in any event; their accountant or solicitor for example, although many were mindful of the expense involved. Others sought guidance from umbrella bodies. Many participants however reported not seeking advice when it may have been useful, not knowing where to go for advice, or seeking advice internally on the understanding that colleagues may not have an in-depth knowledge of the regulations. Many charities will have very little or no contact with the Commission unless they have been brought to their attention by a third party such as an auditor, the annual accounts/report is a cause for concern, or a complaint is made against them. There is clearly a need for greater guidance and support for many charities throughout the sector.

4. THE NATURE OF THE ENGAGEMENT OF CHARITIES WITH THE CHARITY COMMISSION WITH RESPECT TO ITS REGULATORY ROLE

The themes explored in this section relate to the various perspectives of the participants with regard to the regulatory role of the Charity Commission. Although only one charity participant had been directly involved in a formal inquiry undertaken by the Commission, others had been the subject of a preliminary investigation following a complaint, which may or may not have been vexatious in motivation, or had entered into a dialogue with the Commission due to the perceived risk of their operations. Participants from umbrella groups and other stakeholders having close involvement with charities had all had direct experience of inquiries or investigations by the Commission. All participants were aware of the Commission's regulatory

function and had varying views and opinions about this core role in so far as it affected them directly, or the sector more generally.

4.1 The business of the Charity Commission

The remit of the Charity Commission includes the registration of charities, and the identification and investigation of misconduct and mismanagement within the sector. The Commission is also empowered to take remedial and protective action. The statutory role focuses on the conduct of trustees, who are legally responsible for the administration of the charity.³⁰ The Commission also has powers to issue directions and orders, and its powers were further extended by the Charities Act (2016) to enable such actions as the issuing of official warnings and the disqualification of trustees.

The Charity Commission relies predominantly upon reports, complaints and concerns being brought to their attention, from the conviction of trustees for a criminal offence, or from media reports of wrongdoing, which are then assessed according to risk.³¹ Many cases will be dealt with by means of advice and guidance to trustees directly, in order that mistakes or incidences of mismanagement may be rectified. Financial crime and the risk of abuse from terrorism are key priority risk areas, and serious regulatory concerns of this nature would warrant further investigation.³² The power to undertake an inquiry derives from s.46 Charities Act 2011,³³ and makes available the full range of investigatory powers; to gather evidence, for example by ordering the production of accounts and other documents, and the power to obtain a search warrant for the purpose of pursuing an inquiry.³⁴

³⁰ Charity Commission, 'Statutory Inquiries into Charities: Guidance for Charities (September 2017).

³¹ Clive Walker, 'Terrorism Financing and the Governance of Charities' in Colin King, Clive Walker and Jimmy Gurulé (eds) *The Palgrave Handbook of Criminal and Terrorism Financing Law* (Palgrave 2018) 1092.

³² Charity Commission, *Where the Charity Commission investigates charities* 23 May 2013.

³³ Charities Act 2011, s.46.

³⁴ *ibid* s.47 and s.48.

In the USA the approach taken by regulating authorities is quite different. Where trustees have abused their status, or even individuals linked to a charity suspected of financing terrorism, the response has been swift and severe. There is no hesitation to intervene and close down charities, often on the basis of scant evidence.³⁵ The published guidelines are voluntary and aim to assist charities in developing their own approach to counter-terrorist financing. Adherence to the guidelines however does not provide a defence to any civil or criminal liability that may arise.³⁶ The approach has attracted much criticism within the US non-profit sector; accusations of the Treasury exaggerating the threat and of damaging misguided policies, which alienate a potential partner in counter-terrorist finance.³⁷ The same report contrasts this antagonistic stance with the more considered approach taken by the Charity Commission and its willingness to openly recognise the significant contribution of the sector in addressing some of the underlying causes of terrorism.³⁸

There is a danger that the position and standing of the Charity Commission could be seriously compromised if it were perceived as anything less than completely independent.³⁹

4.2 Perceptions of the role of the Charity Commission-from the perspective of clients and stakeholders

4.2.1 Political and sectoral neutrality?

The Charity Commission, in its capacity as partner in the government's PREVENT programme, (part of the wider counter-terrorism strategy CONTEST) has been obliged to focus efforts in this area. Some international charities have reported concerns about its role in policing the system on behalf of the

³⁵ Nicholas Ridley, *Terrorist Financing: The Failure of Counter Measures* (Edward Elgar 2012) 75.

³⁶ US Treasury Department, 'Anti-terrorist Financing Guidelines: Voluntary Best Practices for US-based Charities' (2002 updated 2006).

³⁷ OBM Watch/Grantmakers Without Borders, 'Collateral Damage: How the war on Terror Hurts Charities, Foundations and the People they Serve' (July 2008) 32

³⁸ *ibid* 36.

³⁹ Debra Morris, 'The Charity Commission for England and Wales: A Fine Example or Another fine Mess?' (2015) 91 *Chicago-Kent Law Review* 965,972.

government with respect to terrorism, and the profound shift in focus that this represents.⁴⁰

The appointment of William Shawcross as Chair of the Charity Commission was controversial, and his message during his time in post, particularly with respect to his views on the politicisation of charities, was considered to be closely aligned to the Conservative party.⁴¹ The think tank Claystone, which aims to foster social cohesion with the British Muslim community, pointed to his background as a journalist writing about terrorism, as a right-wing political commentator, and his position on the advisory council of the think tank the Henry Jackson Society, as examples of political bias.⁴² These charges of political bias do not sit easily with the role the Commission adopts as defender of the charities that it regulates against political bias.⁴³

For some, the most recent Chair of the Commission Baroness Tina Stowell represented another politically biased appointment. A committee of MPs rejected the appointment, in part due to questions of impartiality, but was overruled by the Culture Secretary.⁴⁴ Clearly any assertions of political bias within the Commission would not resonate well with the Commission's drive to eliminate party political bias in connection to charities, however Stowell has been at pains to demonstrate her neutrality since her appointment both in writing and by her actions in resigning her political roles.

Some participants were concerned about the question of neutrality:

I think that the Commission has to be very careful to be neutral in political matters and to show that they are neutral. They are dealing with some very contentious matters when it comes to terrorism,

⁴⁰ Victoria Metcalfe-Hough, Tom Keatinge and Sara Pantuliano, 'UK Humanitarian Aid in the Age of Counter-terrorism: Perceptions and reality' (Working paper, Humanitarian Policy Group 2015) 8-9.

⁴¹ Morris (n 39) 971.

⁴² Adam Belaon, 'Muslim Charities: A Suspect Sector' (Claystone November 2014).

⁴³ Morris (n 39) 972.

⁴⁴ House of Commons, 'Report on the Appointment of the Chair of the Charity Commission' (27 February 2018).

radicalisation and so forth, they need to be beyond reproach themselves. When people like the Chair have been outspoken, it hasn't done them any favours. (Interview 28)

Concerns about the relationship between the police and Commission with respect to neutrality also surfaced when Commissioner for Police Sir Hogan-Howe was reported to have issued the warning that the public should take care with their donations as money may end up in the hands of proscribed terrorist groups.⁴⁵ This prompted the umbrella group Muslim Charities Forum (MCF) to express concern that such comments could be harmful.⁴⁶ Further concerns about neutrality were raised recently by the Muslim humanitarian charity Human Aid UK warning against the Commission becoming 'a tool for intelligence agencies and counter- terrorism police to conduct investigations under the radar exploiting the Charity Commission's extensive powers'.⁴⁷

4.2.2 The perception of unfair targeting of Muslim charities

Another area of concern has been the perceived bias of the Charity Commission toward some faith charities, in particular Muslim charities. The valuable contribution made by Muslim charities is undeniable; to communities in the UK and to causes overseas, often in areas where other charities cannot gain access and the humanitarian need is greatest. For example, as Jonathan Benthall observed, Islamic Relief delivers aid in a remote area of Mali where access was possible due to the relationship that had been established with local aid workers, and he draws a parallel with Christian charities having access through church communities in other areas of Africa to deliver assistance to vulnerable people.⁴⁸

⁴⁵ Sam Burne James, 'Met Chief Sir Bernard Hogan-Howe says the public should be careful their charity donations don't go to terrorists' (*Third Sector*, 24 November 2014) <https://www.thirdsector.co.uk/met-chief-sir-bernard-hogan-howe-says-public-careful-charity-donations-dont-go-terrorists/fundraising/article/1323380> accessed 1 March 2020.

⁴⁶ *ibid.*

⁴⁷ Rebecca Cooney, 'Charity Commission Accused of Undue Scrutiny of Muslim charities' (*Third Sector*, 23 September 2019) <https://www.thirdsector.co.uk/charity-commission-accused-undue-scrutiny-muslim-charities/governance/article/1660369> accessed 1 March 2020.

⁴⁸ Jonathan Benthall, 'The Overreaction against Islamic charities' *ISIM Review* 20 Autumn 2007 6

The CEO of MCF estimated that £100 million is donated to Muslim charities each year in the month of Ramadan.⁴⁹ It has also been widely reported that the Muslim community had previously been identified in an ICM poll as the top contributors to charitable causes.⁵⁰ Furthermore, a recent all party parliamentary group highlighted the contribution from Muslim charities as having a demonstrable impact on the social welfare of the UK.⁵¹ They also identified however, that ‘much work was needed in repairing the relationship between British Muslim charities and the Charity Commission’.⁵²

William Shawcross’s remarks ‘the problem of Islamist extremism...is not the most widespread problem we face in terms of abuse of charities, but it is potentially the most deadly’,⁵³ were unhelpful and caused considerable distress amongst Muslim charities at the time.

The Claystone report concluded that Muslim charities had been disproportionately investigated and monitored. This monitoring, which took place without the knowledge of the charities concerned and was based on alleged potential involvement in extremism and radicalisation, amounted to non-evidence-based targeting, according to Claystone.⁵⁴ The Commission however vigorously denies targeting any groups.

According to a *Guardian* analysis of new inquiries initiated by the Commission, 5 out of 20 inquiries from April 2012 to November 2014 focused on Muslim

⁴⁹ Charity Commission, ‘Give Safely to Charities this Ramadan’ 11 May 2018.

⁵⁰ David Ainsworth, ‘Muslim Donors Give More on Average than Other Religious Groups in the UK’ (*Third Sector* 26 July 2013) <https://www.thirdsector.co.uk/muslim-donors-give-average-religious-groups-uk/fundraising/article/1192969> accessed 1 March 2020.

⁵¹ All Party Parliamentary Group on British Muslims, ‘Faith as the Fourth Emergency Service: British Muslim Charities Contribution to the UK’ (2017).

⁵² *ibid.*

⁵³ R Kerbaj, “Deadliest threat” to Charities is Extremism’ *The Sunday Times* (London, 20 April 2014).

⁵⁴ Belaon (n 42).

charities.⁵⁵ This can be compared to the published list of inquiries in 2017 however, which does not reflect this apparent emphasis.⁵⁶

The Charity Commission recently opened a second enquiry into Human Aid UK, prompting renewed allegations of undue critical attention being focused on Muslim charity sector. The charity's Chair also compared the handling of the recent Oxfam investigation, which was concluded in a timely manner with the issue of a warning, with the initial investigation into Human Aid UK, which continued for three years, with matters remaining outstanding.⁵⁷

Some participants from other faith charities expressed their own views during the interview that there was a disproportionate targeting of Muslim charities by the Commission, which they did not consider applied to them:

I think there certainly is (bias from the Charity Commission) when it comes to Muslim charities. But for us I don't think so, no. There is a lot of evidence coming from out of the United Nations that faith-based charity work is enhanced because it is faith based. (Interview 15)

This was echoed by an umbrella group participant:

Many of the members, whether they were Muslim, from other faiths or non-faith based, feel that there has been discrimination against Muslim charities by the Regulator. (Interview 25)

The Chair of Human Aid UK reportedly stated that 'we regularly engage with Muslim charities and we haven't come across a single Muslim charity that hasn't had undue intervention from the Charity Commission'.⁵⁸ There may however be more far-reaching consequences if action is taken against an Islamic charity:

⁵⁵ Alex Delmar-Morgan, 'Islamic charities fear they are being unfairly targeted over extremism' (*The Guardian*, 22 July 2015) <https://www.theguardian.com/society/2015/jul/22/muslim-charities-uk-targeted-extremism-fears> accessed 1 March 2020.

⁵⁶ Charity Commission, Reports of Charity Commission Inquiries carried out under s.46 of the Charities Act 2011.

⁵⁷ Cooney (n 47).

⁵⁸ *ibid.*

When this happens, there is a much wider message sent to the public, and reinforces the perception amongst some, that charities are not providing legitimate humanitarian aid. This can be enormously damaging not just to the charity concerned, but also to other Muslim charities. (Interview 25)

This view is also held by some in parliament, for example Baroness Varsi. In a speech to the MCF she commented on the vilification of Muslim charities, and the regrettable demise of the special relationship that the government had with the MCF due to accusations that had never been proven.⁵⁹ The MCF were also concerned about the potential reputational damage accruing from any association with a statutory inquiry and considered the adoption of their policy to name a charity once an inquiry was open to be manifestly unfair.⁶⁰

The tension between the Muslim charity sector and the Charity Commission is palpable and is reflected in the responses of many of the participants, who considered this a manifestation of unfair bias towards them. This perception of bias could be damaging to the reputations of Muslim charities and to the Charity Commission and therefore needs to be addressed and challenged.

4.2.3 Who should champion the sector?

Having discussed some of the views of participants around bias and unfair targeting, the following themes relate to their perception of how the Commission as Regulator *should* be operating, both from the perspective of charity participants and finally from the perspective of participants from the financial services sector.

Several issues were raised by participants with regard to promotion and advocacy on behalf of the sector, for example: whether the sector as a whole

⁵⁹ Andy Hillier, 'Muslim Charities have been vilified, says Baroness Varsi' (*Third Sector*, 23 February 2017).

<https://www.thirdsector.co.uk/muslim-charities-vilified-says-baroness-warsi/policy-and-politics/article/1425226> accessed 1 March 2020.

⁶⁰ Sam Burne James, 'Muslim Charities Forum Chair Hany El-Banna says Charity Commission should not Name Inquiry Charities' (*Third Sector*, 8 July 2014)

<https://www.thirdsector.co.uk/muslim-charities-forum-chair-hany-el-banna-says-charity-commission-not-name-inquiry-charities/governance/article/1302381> accessed 1 March 2020..

was adequately represented, whether the Charity Commission should be doing more in this regard, and who, if not the Commission, should fulfil this role?

A participant from a major Muslim charity considered that the press could, and actually have on occasion, had a particularly malign influence, acting as a voice for what was described as 'self-styled think tank or research organisations with a particular focus on targeting Islamic organisations:

It is an industry that is very well funded, that very easily picks up on these issues and spins them in a way that causes huge reputational damage... It is the case on the internet that if you say a lie enough times it becomes the truth. (Interview 7)

By singling out a charity in this way, if they happen to be Muslim, the participant felt there is the suggestion of an underlying theme that they are already under suspicion. This creates a sensationalist story, which the charity then has to counter. Many charities in a similar position, however, do not have the resources to do this, which leaves a lingering suspicion. For this charity it was important to tackle some of the wider issues:

Not just necessarily to fix the reputation of the organisation but try and ensure that we have the material and the answers and weapons ready to counter any more attacks in the future. (Interview 7)

The Humanitarian Policy Group report also commented on the 'High media value in allegations of abuse by or of Muslim INGOs'.⁶¹ There was little faith in the willingness of the Charity Commission to assist. As well as the obvious reputational damage which influences donor confidence, this damage may affect the relationship with the charity's bank, thus causing a malign effect with far greater reach.

A compliance officer confirmed that, from the bank's perspective, adverse publicity concerning an organisation may cause them to further investigate and possibly make adjustments in their risk assessment, which could result in account closure:

⁶¹ Metcalfe-Hough et al (n 40).

For a charity there would be an annual review, but there is no guideline as to how frequently you manage your risk. A review could be triggered by an event, and if something came to your attention which indicates greater risk then you take a view on this. You may have to justify this internally, but as long as you followed protocol and used a risk-based approach this would be justifiable. It would probably never become public though. (Interview 17)

There was an expectation amongst many participants that the Charity Commission should respond to a damaging press story, but the response was inadequate, particularly where no wrongdoing had been proven and the charity's reputation had suffered:

They don't do anything to counter the stories, ever. They do something because the press may make a big deal, so they will investigate then, but what they won't do is to defend the charity sector. I've not heard them do that in the press. (Interview 10)

According to some commentators though, charities do not have an expectation of being portrayed in a favourable light by the media, and can appear defensive.⁶² Whilst charities may consider their treatment in many cases unfair, there was little faith amongst the interview participants that the sector was being promoted as well as it should be. Howard Lake, publisher of UK Fundraising, commented that 'very few people stand up for charities beyond the standard rebuttal, and that is not good.'⁶³

Other participants suggested that the Commission should promote examples of good governance or create newsworthy stories of excellence in this field to counter the damaging negative press. (Interview 9) However, many recognised the difficulty in promoting 'good news' stories but were nevertheless critical of the Commission in its apparent unwillingness to promote the sector in a more positive light generally. Reminding the public that the proportion of charities

⁶² Oliver Bennett, 'Why we've Lost Faith in Charities' (Management Today 19 February 2018 Updated 11 January 2019) <https://www.managementtoday.co.uk/why-weve-lost-faith-charities/reputation-matters/article/1369094> accessed 1 March 2020.

⁶³ *ibid.*

involved in a particular aspect of investigation, compared to the total population of charities, would be helpful in countering negative publicity. (Interview 10)

Others felt not only should the Commission be doing more to stand up for charities, but should also be working with other third parties (for example the press) to promote the sector:

When all of this nonsense was going on with the Daily Mail (with reference to Olive Cooke and other victims of aggressive fund-raising initiatives by charities) no one at the Commission took charge, and was brave and said “no, we are not having this newspaper destroying our sector.” (Interview 11)

Olive Cooke’s family later confirmed that aggressive fund-raising methods had not been the cause of her suicide, but the report had made an indelible impression.⁶⁴

According to a participant from a major charity, there was also the view amongst some members of the public that the third sector does not add value:

...the Charity Commission needs to come out and counter that. It’s an issue with the Commission’s role, whether they can deal with that, as well as the perceived public lack of trust in charities... (Interview 13)

Saxton reflects on the changes in the way news is conveyed, from the decline in printed media with editorial input where important news stories would be covered, to the rise in the consumer choosing how they inform themselves. For an increasing number of people this will be through personality-based online media in which the interest of a story takes precedence over the importance of a story.⁶⁵ This has implications for the charity sector, not only in the way charities should approach fund raising, but also for the Charity Commission and how it could, and perhaps should, be using its influence to promote the sector

⁶⁴ *ibid.*

⁶⁵ Joe Saxton, ‘High Five: Five ways on which the world of media has changed in the last two decades’ (NfpSynergy blog, 21 November 2018) <https://nfpsynergy.net/blog/five-big-ways-media-has-changed-last-two-decades-charities> accessed 1 March 2020.

generally. More specifically the message from several participants was that the Commission should be more forthcoming in addressing issues arising from media coverage which may affect the reputation of charities, and to take a proactive stance in countering negative messaging.

The Charity Commission perhaps does not see this as their role. As Baroness Stowell reminded the National Council for Voluntary Organisations (NCVO) at their annual conference, 'The Commission's job is not to represent charities to the public, but to represent the public interest to you.'⁶⁶

The NCVO has stated that the Commission is not the appropriate body for championing the sector, citing the possibility of confusion of boundaries between what is expected of charities in relation to their statutory obligations and good practice, with the potential for the Commission to extend its Regulatory reach.⁶⁷ What is perceived by the NCVO as being an extension of their role would detract from the current main focus of the Commission, which is its Regulatory function. This suggests therefore that they may not be in a position to do both effectively.

4.2.4 The duality of roles - is there conflict of objectives?

For many of the participants expressing a view, the dual role of the Charity Commission did not appear to be problematic and several considered that it was best placed to tackle both roles, notwithstanding the matter of underfunding. However as to the question of whether the Commission should fulfil both roles, but as two separate entities, most were not in favour:

I think it's probably better together because in theory there should be a synergy; they should be seeing what the investigatory arm is doing and allowing that to guide them with their publicity

⁶⁶ Liam Kay, 'People Trust Charities no More Than Strangers They Meet, Says Chair of Regulator' (*Third Sector*, 16 March 2018) <https://www.thirdsector.co.uk/people-trust-charities-no-strangers-meet-says-chair-regulator/governance/article/1462216> accessed 1 March 2020.

⁶⁷ NCVO, 'What we believe about charity law and regulation' Opinion piece <https://www.ncvo.org.uk/policy-and-research/charity-law-and-regulation/charity-law-and-regulation> accessed 1 March 2020.

and information... If you have a single service and they are getting results you can put a tick box up and say, "this is what we've done." If you separate them, the advice side will become fairly impotent, it will get cut off; its funding will drop. (Interview 18)

A comparison with other sectors can be made where the division of roles has been achieved, though not without its challenges.⁶⁸ The division of roles, in the view of one participant had not been satisfactory, and would therefore not favour this approach for the Charity Commission:

...with the Law Society taking an advisory and supportive role and the Solicitors Regulatory Authority acting as the Regulator, and both came out of the Law Society, but there is a lot of tension there. (Interview 12)

Others envisaged that the media focus would be on the Regulator investigating wrong-doing, and the funding for the less prominent advisory function would decrease to an even greater extent, partly because results would be difficult to quantify. (Interview 9)

For others, it was a matter of the weight of authority behind the advice and they saw no conflict between the roles. The police for example give advice on crime prevention and encourage people not to join gangs and commit crimes, but this does not prevent them from arresting those that do. Similarly, the Commission explains how to comply, and they take action in cases of non-compliance. (Interview 26)

However, many commented that the weight behind the guidance was insignificant as it was no longer personalised and thus could not be relied upon. There was too much room for interpretation; the Commission was no longer adequately fulfilling this role so this should fall to other agencies.

Those who expressed a view endorsing the Commission's current role tended to be from larger charities who would possibly have few problems navigating and interpreting their advisory output, and having recourse to other advice givers,

⁶⁸ Matt Byrne, 'A New Model Law Society' (*The Lawyer*, 5 September 2016) 6.

unlike some of the smaller charities. The view from many of these, as outlined in the previous section, was that the advisory output was confusing and inadequate.

There were some who felt it would be inconceivable to approach an agency with a query which could potentially demonstrate a breach of regulation and alert the very agency who could take action against them.

What is causing anxiety about the dual roles is the adversarial tone that people perceive coming from the Charity Commission. (Interview 13)

When exploring who they considered best placed to fulfil the roles, the question of underfunding was raised by most of the participants, and many considered that, if this were to be addressed, then the Charity Commission would be the preferred body.

Many of the participants had perhaps unrealistic expectations of the advisory role of the Commission. There is a wide variety of umbrella groups available: focusing on small charities, supporting specific roles within a charity, or specialising in a certain aspect of administration such as finance or fundraising. Some participants reported membership of at least one organisation, but there were equally many who did not subscribe to any.

The presence of too many different organisations offering advice was problematic for some participants. Not only was it confusing for some, but there was an overlap in the provision of advice, and this resulted in a waste of resources. This was especially relevant as many of the advice-giving bodies were themselves charities.

There are too many umbrella bodies covering a whole multitude of things. I think we have missed opportunity after opportunity for proper rationalisation of them and they end up playing us off against each other. (Interview 27)

Several participants though, who were members of umbrella bodies, considered that the answer lies in strengthening the roles of specialist organisations with increased funding and greater visibility:

I think there is a much bigger role that the sector bodies, in particular the Charity Finance Group and NCVO should be taking on these issues and they are the organisations who should be providing things like best practice advice. The Commission should be providing advice such as, this is how you avoid problems, basically, rather than this is how you can do it better. (Former employee of the Charity Commission - Interview 26)

For most participants there was no conflict in objectives associated with the dual roles of the Charity Commission and significant support for the notion that this body should be given the necessary funding to fulfil these roles more effectively.

4.2.5 Who should the Charity Commission be regulating?

The wider question of who should be regulated is addressed by Ainsworth, who points to the impossibility of regulating entities that are unregistered and are not required to produce accounts. A very large number of charities are beyond easy reach of the Commission.⁶⁹ The Commission may theoretically intervene in any case where the purpose of the entity may be considered charitable, regardless of how the entity is constituted or named. However, in practice this is less likely to happen as such entities are likely to be less visible.

Ainsworth also maintains that many charities would be better regulated by other bodies and should not be registered with the Charity Commission and enjoy charitable status. Their political nature, for example, or the restrictions on the groups of people who benefit from the charity, based on the ability to pay for its services, should be an impediment to charitable status and the attendant privileges that brings.⁷⁰ The privileged position includes tax advantages as well

⁶⁹ David Ainsworth, 'Charity Regulation is not Fit for Purpose' (*Civil Society*, 21 September 2018) <https://www.civilsociety.co.uk/voices/david-ainsworth-charity-regulation-is-not-fit-for-purpose.html> accessed 1 March 2020.

⁷⁰ *ibid.*

as a high level of public support and preferential access to government funding and grants from foundations and other bodies.

There was a general recognition from participants that the Commission was not in a position to effectively regulate all the entities that fell under its jurisdiction, and there should be a rationalisation of what constitutes a charity which would effectively exclude some. Some participants considered that the Commission should be concentrating its efforts and targeting more high-risk entities such as religious establishments and cultural centres to encourage registration as charities. (Interview 26)

Others took the view that small charities should be largely excluded from regulatory oversight. (Umbrella-type body, Interview 11) Whereas another suggested that the major charities should not have charitable status and enjoy the inherent advantages this brings, but instead have their constituent parts reconstituted as smaller charities. (Interview 3) Participants from some major charities, however, considered that many micro/small charities were unsustainable, duplicated their efforts and as such wasted public donations. (Interview 26, 27 and 28)

The public perception is that there are a lot of organisations who are staking their own claims and spending lots of money on marketing, essentially to take market share from somebody else, and the public don't like that. (Interview 26)

Another participant advocated limiting small charities, especially those with a narrow focus:

If they have no prospect of operating as a viable business, they should not be allowed. The Charity Commission should not be registering many of these charities. Otherwise there should be some model that allows a charity to set up for a limited period and then automatic closure unless they can show they are a going concern. (Interview 12)

This would be problematic for the Charity Commission though. It has no powers, for example, to make a judgement when registering an entity either on

the need for the particular charitable purpose intended to be pursued, or on the likelihood of it achieving its charitable objectives.⁷¹

In terms of who the Commission should be regulating, there was quite a wide spectrum of views, nevertheless most participants considered its role was overextended and beyond its capacity which seriously impacted on its effectiveness.

4.3 Perceptions of the role of the Charity Commission from the perspective of the financial services sector

The strength of its regulatory role may influence the perception that other third parties have of the sector. This has been particularly palpable in the reaction of banks to the risk that the operations of some charities present. A participant from an umbrella body noted that several representatives from banks had privately confided their lack of confidence in the Regulator:

That is one of the reasons they (the banks) give from time to time about why they ask for so much due diligence and they ignore so much of the Charity Commission stuff- because they just don't have much confidence in it. I think they think it's too small, I think they think it's under-resourced and it doesn't have the expertise in financial crime and terrorist risk to make it feel really confident.

(Interview 4)

A participant from a large international bank suggested how relationships between the Commission and banks could be improved, which in turn could affect their assessment of the risk that a charity represents:

I think the bank's perception of the Regulator does affect how they deal with individual charities. What banks always want is for those that use the financial services operate using the same systems and methodology as they do, because that makes it easier for them. The Charity Commission are working off a different agenda... If you are looking at what the Charity Commission can do to help charities it would be to have a standard screen-based accounting package which all charities should adopt... Cash, cheques and poor record keeping are a complete nightmare for their banks...

⁷¹ Richard Fries, 'The Charity Commission for England and Wales in Klaus Hopt and Thomas Von Hippel (eds) *Comparative Corporate Governance of Non-profit Organisations* (CUP 2010) 904.

Streamlined software integrated with the banks system makes it easier to understand what is happening on a week by week basis on the operation of the charity... That would go a long way to allay the anxiety of the banks. (Interview 34)

The obvious differences between the two entities lie in the profit motive, but also the approach to regulation generally, which according to another participant from a bank was far less stringent. There was less understanding by the Commission, in his view, of the financial risks to charities including the risk of terrorist financing, than would be the case for other regulators, and they have less control over their sectors. He also pointed to the huge fines levied on financial institutions for non-compliance, and the absence of similar penalties levied by the charity regulator. (Bank -Interview 33)

This highlights the current tension between the sectors; matters of regulatory compliance and how they are dealt with by the Charity Commission can influence the relationship and, as such, affect the perception of risk that charity clients present.

4.4 The involvement of other third parties-the alternative police?

The Charity Commission relies on the flow of information from those closest to the bodies concerned in order to determine where the focus of its investigatory powers should lie. One of the sources that the Commission is relying on more frequently is the accountancy profession. However, many participants from charities and umbrella bodies were uncomfortable with what they regarded as the enhanced role of accountants in policing the system:

We've raised this concern many times. I think accountants are being asked to be policemen for the Regulator because the Regulator doesn't have the resources to investigate charities enough itself. (Umbrella body - Interview 4)

As outlined in Chapter Six, many charities rely on their accountants and auditors as a source of advice and expertise. The danger is that the relationship

will suffer if they perceive that the role of the accountant has changed to the extent that they have a conflict in loyalties.

If they know everything that they tell them (their accountant/auditor) is going straight back to the regulator then they're not going to do that, they're going to talk to somebody else or they might not do it (seek advice or test their processes) at all. (Interview 4)

In a guidance document for auditors and independent examiners, the Commission for the first time, gave examples of matters that would be helpful to the Regulator to report in the absence of a legal requirement to do so. A donation from an unknown source, which could possibly be susceptible to abuse would be one such example.⁷² Reference is also made to existing statutory powers of reporting relevant matters.⁷³ The Regulator is clearly advocating a 'when in doubt report it' approach in this and subsequent updated guidance.

The reticence of auditors to report to the Regulator was highlighted in the recent government report into the collapse of Kids Company.⁷⁴ This undoubtedly prompted the published guidance in this regard and the renewed focus on the potential for auditors to assist the Charity Commission in policing the sector.

A charity accountant participant confirmed that they were now obliged to make a separate report on any matter where a qualification has been noted in the course of an independent examination or audit, in the form of a management or findings letter setting out concerns, and took the view:

It is pointless really to make the same report, it's not as if the accounts are not being filed, I don't understand that. (Interview 29)

⁷² Charity Commission, 'Reporting of Relevant Matters of Interest to UK Charity Regulators; A Guide for Auditors and Independent Examiners' November 2017.

⁷³ Charities Act 2011, s.156 and s.159, and in the case of exempt charities, s.60.

⁷⁴ Public Administration and Constitutional Affairs Committee, *The Collapse of Kids Company: Lessons for charity trustees, professional firms, the Charity Commission and Whitehall* (HC 2015-16, 443).

The participant viewed the additional requirement as ‘not particularly helpful’ but not being a huge issue either ‘just something else you have to remember to do.’ (Interview 29) In her opinion though, the relationship with the client did not appear to be an issue.

Another accountant participant took the view that the responsibility placed on accountants and auditors to carry out due diligence and report to the Commission was increasingly onerous:

In high profile cases like Carillion and Kids Company everyone thinks accountants should have spotted the signs and now they are expected to do more, and act as agents for the Charity Commission. (Interview 30)

Reporting to the Commission on matters outside those required by statute, on matters of material significance, would certainly present a dilemma for him, especially with respect to the smaller charities. Increasingly the focus on the auditor, and the consequences for getting it wrong, added to the burden of responsibility, and the view that they were being asked to police the system. (Interview 30)

The head of accounting services at the Commission commented that ‘auditors and examiners play a vital role in supporting us in carrying out our regulatory function.’⁷⁵ The Commission’s monitoring review found that in less than 25% of cases where reports of ‘matters of material significance’ should have been made, were being made, and many were not being made in a timely manner.⁷⁶ The reason for this is unclear, however it was apparent that reporting was not being effectively carried out. Building effective working relationships with those in the profession who can provide relevant information to the regulator is vital. McDonnell and Rutherford note that stakeholders such as funders and auditors

⁷⁵ Nigel Davies quoted in Liam Kay, ‘New auditors guidance includes two extra “matters of material significance”’ (*Third Sector*, 12 April 2017) <https://www.thirdsector.co.uk/new-auditors-guidance-includes-two-extra-matters-material-significance/governance/article/1430428> accessed 1 March 2020.

⁷⁶ Charity Commission, *Accounts Monitoring Review: Reporting Matters of Material Significance by Auditors* February 2018.

are more likely to make complaints that subsequently require regulatory action.⁷⁷

In its Report into the collapse of Kids Company, the recommendations directed at the Charity Commission urged them to investigate adverse media reports, and to encourage journalists to proactively alert the Regulator by lodging formal complaints when areas of concern are uncovered. They are also advised to promote public awareness more generally in relation to reporting concerns of abuse or wrongdoing within the charity sector.⁷⁸

Some participants considered that the Charity Commission needed to be more powerful and to act more decisively and expeditiously.

They rely on informants saying there is a problem, and then they will carry out an inquiry, so there may be an awful lot of wrongdoing that does not come to the attention of the Regulator. (Interview 27)

According to a participant from an umbrella body and legal practitioner in charity law, the Charity Commission is slow to respond:

There have been charities, and they tended to be Muslim but also Irish charities, where there have been concerns about the source and destination of funds, but the charity may have been operating for 2 or 3 years, and of course the trustees are involved so they are not going to report it...by the time they have done all that (the Commission taking steps in response to formal complaints or initiating their own investigation) the charity has closed down, and that is what has tended to happen. (Interview 12)

Although many participants were concerned that slow or ineffective responses by the Charity Commission had a negative effect on how the sector was perceived, the involvement of third parties such as accountants in policing the sector was not generally welcomed.

⁷⁷ Diarmuid McDonnell and Alasdair Rutherford, 'The Determinants of Charity Misconduct' (2018) 47 *Non-profit and Voluntary Sector Quarterly* 107,120.

⁷⁸ Public Administration and Constitutional Affairs Committee (n 74) 36.

5. MATTERS OF ACCOUNTABILITY

The Charity Commission is a unique organisation: an independent regulator of entities that differ immensely in terms of size, of mission and of legal constitution, for which accountability lies with, to a great extent, unpaid volunteers. There are some who argue that there is little accountability within the sector:

It's not regulated in the sense that the FCA does for financial institutions, the Law Society and SRA for solicitors and the Institute for Chartered Accountants for the accountancy profession. They are on it all the time, and it is a professional offence; solicitors have been imprisoned, not for being dishonest but because they did not spot the signs... in the last 20 years that I have been acting for charities I've only come across once that anyone has been convicted for failings under the Terrorism Act as a trustee and that was a failure to make a suspicious activity report. (solicitor- Interview 12)

The recent legislation in the form of the Charities Act 2016 has brought some redress though in the disqualification of trustees if they are deemed to have fallen short of their duties. Several directors of Kids Company had disqualification proceedings brought against them by the Insolvency Service, due to the failings identified in the charity, which will impact on their ability to run companies.⁷⁹ Although this represents a civil action, failure to comply with a disqualification order is a criminal offence to which a fine and/or custodial sentence may be attached.⁸⁰

Many participant trustees took the view that, although the regulator could conceivably take action against trustees in some circumstances, they refrain from doing so, and have therefore take a pragmatic view:

I think the biggest risk to trustees is that we are financially liable, but if the regulator started to hit trustees with financial liability then we would all leave. if that was allowed, I don't think anyone would sign up for it. (Interview16)

⁷⁹ Julia Irvine, 'Kids Company directors face disqualification proceedings' *Economia* 31.7.2017 <https://economia.icaew.com/en/news/july-2017/kids-company-directors-face-disqualification-proceedings> accessed 1 March 2020.

⁸⁰ Company Directors Disqualification Act 1986, s.13.

There is a balance to be struck; trustees clearly have a responsible role in the governance of a charity, however, if there are failings and the repercussions are severe for individuals this could seriously affect participation.

6. WHO SHOULD PAY FOR THE CHARITY COMMISSION?

The question of funding was raised as an issue in the Hodgson Report, which made suggestions regarding charging for Charity Commission services, to increase the availability of funds so that it may conduct its role more effectively.⁸¹ The views of stakeholders were sought, and the argument put forward that the government does not have funds at its disposal with which to support the Commission. O'Brien from the Charity Finance Group rejected this: "This isn't an argument. Government spends over £760bn a year on public services. It just isn't credible to say that it can't spend a few million extra on regulating a sector which generates billions to deliver services for public benefit."⁸² Further objections relate to the possible compromise of independence of the Regulator if charities pay for the service, and the effect this may have on donor confidence.⁸³

This has proved to be a highly controversial issue. The prospect of charities paying for the regulator did not find much favour amongst the participant group. Most of the charity participants were unequivocal in their opposition to this proposal.

All the participants who expressed an opinion recognised the necessity of having effective regulatory oversight in order to maintain public trust in the sector, and most held the view that the Charity Commission was best placed to fulfil this role.

⁸¹ Hodgson Report (n 2) 72-77.

⁸² Andrew O'Brien, 'Charging Charities for Regulation isn't Inevitable but it is Risky and Inefficient' (*Civil Society Voices*, 4 November 2016) <https://www.civilsociety.co.uk/voices/charging-for-regulation-isn-t-inevitable-but-it-is-risky-and-inefficient.html> accessed 1 March 2020.

⁸³ *ibid.*

People are going to think “I don’t want my money to go to pay for the regulation, to go to the government. I want my money to pay for homeless people in my town.” (Umbrella body- Interview 11)

For others this would demonstrate a lack of respect for their role in civil society

I think it would send the wrong message (to charities.) The government should be grateful that charities are stepping up and taking the slack where they are not operating. They should not then be charging for the service; its petty and short-sighted. (Large charity- Interview 16)

For some it was a matter of fairness and external perception; the perception of the public, for example, that they would be paying twice:

The state isn’t always the most efficient or effective way of delivering some of those services so actually the state is getting quite a good deal from the charity sector. It would feel like double dipping in the taxpayer’s pocket. You give your money to charity then they hand part of it over to the regulator, but you have already paid through your taxes. (Large charity-Interview 9)

Amongst the participants who objected to charges, several from smaller charities considered that this would be acceptable for major charities:

If you are a larger charity and asked to pay £10,000 a year towards the Charity Commission and your income is in the millions, why would you object to that? (Micro charity-Interview19)

The minority of participants in favour of charging were all from major organisations for whom the extra levy would make little difference and viewed as another operational cost to be absorbed by the business. Furthermore, they concurred with the view expounded in the Hodgson report “the reason of principle that these resources could come from charities themselves is a simple one. Charities gain a great deal from the confidence of their ‘brand’ from the fact they are regulated by the Charity Commission.”⁸⁴ In the proposed consultations with interested parties, it is anticipated that only the larger charities will be charged.⁸⁵ However, some participants felt that there should be no exceptions:

⁸⁴ Hodgson Report (n 2) 73.

⁸⁵ Helen Stevenson, ‘Why we need to be an Enabling Regulator-and What that Means for our Funding’ (Charity Commission blog, 3 November 2017).

Charging should be done on a pro-rata basis, but should be done for every charity, because I think there are too few barriers to entry to the sector... so if you want to be a charity at all you have to pay towards regulation. That would improve the overall efficiency and impact of the sector. (Interview 26)

Another participant went further to suggest that if small charities were not able to compete in the market, their existence should be questioned:

I know a lot of very small charities would struggle (if they had to pay) but then there are lots of very small charities who you really wonder if they should exist as small charities, maybe this is just the cost of running a charity, that you should pay towards the infrastructure to keep donors' money safe, and there are costs to that - it's not free. If they can't cover the cost perhaps they shouldn't be operating at all or should join forces with another charity, that's what a lot are doing now anyway. (Interview 28)

The discussion around charity regulation and how this should be funded continues. Participant responses suggest that the Regulator requires increased funding to effectively fulfil its role, and many believe that its role should be augmented to further support the sector. This is an important issue that needs to be addressed.

7. CONCLUSION

The discussion in this chapter has focused on the relationship between charities and the Regulator, and how this affects charities' understanding of the regulation and their level of compliance. As a key stakeholder, the views of financial service providers and how they perceive the role and effectiveness of the Regulator were also relevant, as this may affect their relationship with charities.

The role of the Charity Commission has clearly evolved over the preceding years and the focus settled more firmly upon its regulatory role, at the expense of its advisory role. For many charities this has left a void. Although some participants

<https://charitycommission.blog.gov.uk/2017/11/03/why-we-need-to-be-an-enabling-regulator-and-what-that-means/> accessed 1 March 2020.

and umbrella bodies were satisfied with the guidance provided, many others were, for various reasons, unable to find the support they required from this source. Some certainly had unrealistic expectations of what was achievable, given the policy decision to de-emphasise this aspect of the Charity Commission's work, and the rise in demand overall for its services. There was a clearly expressed need by many though, for more bespoke guidance than was currently available to them. Some relied heavily on fellow trustees, sometimes recognising that advice may not be correct, but finding no affordable alternative, or possibly knowingly proceeding in ignorance. Others sought other third-party advice, recognising that this was an essential cost to the charity.

Accountants were often the most trusted source of advice and guidance, with specialists in charity accounts fulfilling a particularly useful role in this regard, although engaged by only a small minority of the participants. Umbrella groups were considered useful by some, especially with respect to financial matters, however many did not use this resource, citing cost of membership or an overwhelming number of options with overlapping missions as reasons.

Whilst many consider that the Charity Commission is best place to fulfil this advisory role, others suggest that alternative avenues should be pursued. The lack of funding appears to be a limiting factor, in addition to a lack of will for the coordination of an alternative solution.

With respect to the regulatory role, matters of political and sectoral neutrality were an issue for many participants, and the question of whether Muslim charities receive undue regulatory attention was also highlighted. Although the sample of Muslim charities was small, the perception of some other non-faith charity participants and those representing other faiths concurred with this view.

The data analysis also suggests that more should be done to promote the sector and counter negative messaging, which affects public trust and confidence in

charities. Opinion was divided as to whether the Charity Commission or another third party should fulfil this role, although most favoured the former.

With respect to the duality of the Commission's roles, a small minority considered there was an inherent conflict of objectives, and most saw little merit in splitting the roles. The adversarial tone emanating from the Commission was of concern to some. Many agreed that the Commission was no longer in a position to carry out both roles effectively.

Participants from the financial services sector perceived a lack of rigour and effectiveness in the regulatory role of the Charity Commission, which affected their perception of risk in providing services to charities. Other third parties noted the increased reliance on accountants to police the system, which was not only onerous, but could potentially damage the relationship with charity clients. Failures in the reporting system were also noted with unnecessary reporting and a slow response rate by the Commission where matters of concern were reported.

Many of the criticisms of the Commission had at their core a chronic lack of funding, with the majority of participants considering that the Commission could operate effectively and efficiently if adequately funded by the government. Very few participants though supported the proposal currently being debated that charities should contribute to the cost of regulation.

The Charity Commission has an important role to play with respect to CTF regulation: clarifying the requirements and assisting charities in its implementation. Charities are left to determine their own level of risk. Analysis of the data suggests that for many the requirements are unclear, which may lead to over-compliance, or in some cases inadequate compliance, and assistance is needed for effective implementation where this is necessary, which may require a more bespoke approach. In terms of the indirect effects on charities of the regulation, the Charity Commission has an equally important role in engaging with other stakeholders in highlighting issues such as bank de-risking and the

consequences for charities, and working towards solutions; clearly these issues affect the capacity of some charities to fulfil their charitable purpose.

CHAPTER 9: CONCLUSIONS AND RECOMMENDATIONS

1. INTRODUCTION

This thesis focuses on the complex relationships between the counter-terrorist finance legal framework, the charity sector and other stakeholders who could potentially have an indirect influence on the operating capability of domestic charities. This research suggests that regulatory compliance has been weak and ineffective within many charitable organisations and the current regulatory environment has also influenced the behaviours of stakeholders such as banks to the detriment of some charities.

As outlined in the introduction to this work, there has been very limited prior research into the awareness of the CTF legal framework and the response in terms of compliance from individual domestic charities, hence the need for the current research exploring how charities experience the regulation. Prior research has also highlighted certain aspects of the CTF regulatory environment which have impacted on the operating capability of some charities. The impact has been particularly acute for organisations distributing humanitarian aid, and those experiencing the effects of banks de-risking. This appears to be an ongoing concern.¹

Regulatory attention has also focused on third-party financial partners, such as banks and Money Service Businesses on which charities rely to carry out their operations. The compliance burden on banks in particular may affect the decisions they make with respect to risk. There is a body of evidence to suggest that banks' decisions to de-risk is affecting charities and may be disproportionately affecting Muslim charities.² This area therefore warranted further enquiry.

¹ For example, Tom Keating and Florence Keen, 'Humanitarian Action and Non-state Armed Groups: The Impact of Banking Restrictions on UK NGOs' (Chatham House 2017).

² Chapter One s.3.

Charities fulfil a vital role within society, for example in delivering goods and services to areas which would not otherwise receive support, both in the UK and overseas. The impact of the domestic charity sector is significant, facilitated by substantial income generation and the breadth of scope of the charity sector.³ Therefore, matters concerning effective regulatory compliance and confidence in the sector are critical to its success. Furthermore, matters affecting their ability to pursue their charitable purpose may impact on the provision of these services and society in general, which underlines the importance of this study.

The research makes an original contribution to the available knowledge, providing new insights and perspectives by uniquely analysing the relationships between stakeholders in a number of dimensions, from the perspective of charities. The following overarching research questions are addressed through desk-based doctrinal research and qualitative empirical research, derived from 34 semi-structured interviews with charity participants and various commercial partners: To what extent is the counter-terrorist finance legal framework effectively implemented by domestic charities? And how does the counter-terrorist finance regulatory environment affect the capacity of domestic charities to fulfil their charitable purpose? These questions are explored by answering the sub-questions:

- What are the challenges relating to the environment in which NPOs may operate, and are they susceptible to abuse for the purpose of financing terrorism?
- How has the regulatory environment evolved and are there any unintended consequences flowing from the implementation of the regulations?

³ Charitable income in one year regulated by the Charity Commission alone has totalled over £79 billion: Charity Commission, *Annual Report 2018-2019* HC 2318 12.

- How are the regulations implemented in practice?
- To what extent does the regulation impact on the operations of charities?
- How does the relationship with the Regulator affect charities' understanding of the regulation, and their level of compliance with the regulation?
- To what extent do matters of regulatory compliance impact on relationships between charities and financial institutions?

The characteristics of terrorist financing, and the wider environment in which terrorists operate are volatile, uncertain and complex. In Chapter Three some of the characteristics associated with this complex crime are discussed, for example, the availability of multiple sources of funding and vehicles to transfer and store funds, the constantly evolving nature of terrorism and ease of access to financial services. Charities operating in areas of political instability and aid convoys have been identified as particularly at risk of being used as a vehicle for terrorist financing.⁴ Certain factors suggest the particular vulnerability of Muslim charities, due to the zakat system of charitable giving, less stringent regulatory oversight in some cases and the vulnerability to abuse of Islamic banking used by charities. The treatment of Muslim charities post-9/11 in the US also served to fuel suspicion of the sector.⁵ There is, however, a lack of convincing empirical evidence to substantiate claims that the charity sector as a whole is particularly vulnerable.⁶

The question of the evolution of the international regulatory framework, developed to address terrorist financing, particularly since 9/11 as part of a wider global strategic response is addressed in Chapter Four. The Financial Action Task Force (FATF), as a leading protagonist, has exerted significant

⁴ HM Treasury and Home Office, 'National Risk Assessment of Money Laundering and Terrorist Financing' (October 2017) 73.

⁵ Chapter Three s.3.2.2: Chapter Four s.5.4.1.

⁶ See for example; Stuart Gordon, 'The Risk of De-risking: The Impact of Counterproductive Financial Measures on the Humanitarian Response to the Syrian Crisis' (20 March 2019) <https://blogs.lse.ac.uk/crp/2019/03/20/the-risk-of-de-risking-the-syrian-crisis/> accessed 1 March 2020; Peter Romaniuk and Tom Keatinge, 'Protecting charities from terrorists...and Counter-terrorists: FATF and the Global Effort to Prevent Terrorist Financing Through the Non-profit Sector' (2018) 69 *Crime Law and Social Change* 265, 268.

influence on national governments globally to ensure that an appropriate response to the threat is made, for example, regarding the regulatory framework governing institutions such as financial services providers and charities, considered vulnerable to abuse. This indirect influence from the FATF has meant that individual states may determine how they respond. Some consequences flowing from implementation of the regulation include restricting NPOs operations in the pursuance of compliance ratings with respect to FATF recommendations;⁷ the disproportionate focus on Muslim charities in the US, as mentioned above; and the consequences of bank de-risking which has left some vulnerable communities financially excluded,⁸ charities without banking facilities⁹ and the closure of Money Service Businesses' accounts.¹⁰

This research has provided a contextual review of the regulatory landscape highlighting the inter-connectivity between the actors and forces which exist in this environment, which may also influence the operations and regulatory governance of charities in the domestic jurisdiction. This is a dynamic regulatory environment which is subject to ongoing development as various actors build their knowledge and develop organisational procedures to accommodate ongoing threats, whilst providing operational frameworks to enable charities to continue to fulfil their objectives. It is this dichotomy between establishing a robust compliance framework and enabling the fulfilment of operational objectives which has created a significant challenge for organisations such as the Charity Commission. The consideration of the role of the Commission and the relationship with individual charities provides a valuable contribution to the debate concerning the desirable parameters of the responsibility of this organisation.

The doctrinal research was developed further through original empirical research. Analysis of the empirical data focused on three distinct relationships which have been challenging for organisations within the charity sector;

⁷ Chapter Three s.5.1.2.

⁸ *ibid* s.5.2.3.

⁹ *ibid* s.5.2.

¹⁰ Chapter Five s.5.2.1.

engagement with the regulation; engagement with the financial services sector and engagement the Charity Commission. In this analysis, it is apparent that there have been both direct and indirect effects on the domestic charity sector, which will be considered in turn in the following sections. The Charity Commission has been a key protagonist in the engagement with the regulation as well as promoting compliance within the sector. The inter-relationships between the charity sector, the regulation itself and the Commission (as the sector regulator) is therefore key to the first part of this current discussion. The inter-relationships between the afore-mentioned pivotal structures and the financial services sector is also relevant to the second part of this discussion.

The analysis of both direct and indirect effects of the regulatory framework, presented in the following sections, is a synthesis of the findings from both the doctrinal and the empirical elements of the research in answer to the research questions.

2. DIRECT EFFECTS OF THE REGULATION ON THE DOMESTIC CHARITY SECTOR

The direct effects of the regulatory framework result from the rules applied in individual countries, in this case the UK, that have been instituted to meet their policy goals. The processes that charities are required to follow should be logical and objective, resulting from a clear definition of compliance provided by the Charity Commission as regulator for the sector. In its interpretation of the FATF Recommendation 8, The Charity Commission directs charities to take a risk-based approach to compliance, which involves having sufficiently rigorous control mechanisms in place to reduce the risk of terrorist abuse, and to protect charity assets.¹¹ The challenge for the Commission is to demonstrate a definitive action plan, to communicate this to charities and to be accountable for this.

The analysis of the interview data suggests there were several significant direct effects of the regulation on the participant organisations. Firstly though, for

¹¹ Charity Commission, 'Compliance Toolkit: Protecting Charities From Harm' 2012.

some charities especially those with a local focus and small to medium in size, the regulation meant very little in terms of their understanding and awareness; some were completely unaware of the risk to the charity sector as a conduit for terrorist financing. This is perhaps unsurprising, as terrorist financing risks are generally deemed to be low, however the risk of occurrence of other financial crimes such as money laundering and fraud had also received scant consideration by some participants. In the wider context of financial crime this failure to assess possible risks, general lack of awareness and consequent lack of response is perhaps of greater concern. For many participants the assessment of any risk did not feature in the general management of the charity.

In this context, many of the participants who were aware of the regulation expressed the need for greater assistance in matters of compliance. Based on the analysis, some were clearly responding inappropriately, whereas others cited different challenges with implementation, for example, those concerning due diligence and navigating various sanctions lists, which required assistance by third parties. The research findings also indicate that the role of the trustee, the degree of uncertainty, the lack of training etc. combined with negative media exposure has, to some participants, had a direct negative effect on attitudes to trusteeship. The charity sector relies heavily on trustees and other volunteers, who give generously of their time and expertise. There therefore needs to be a proportionate response with respect to the requirements of the regulation and level of due diligence required, with sufficient guidance offered so that volunteers feel comfortable with their role. This may also encourage more diversity in trusteeship, with the potential for widening the skill sets and experience individuals can bring to the role.

This current research concludes that the sources and availability of regulatory guidance and advice are dispersed between the Charity Commission, various umbrella groups such as the Charity Finance Group, accountants and to a lesser extent to solicitors. The availability and perceived reliability of such guidance and advice was variable and dependent on the source. Many participants accepted that the Charity Commission is currently over-stretched, and the

provision of advice has been de-emphasised due to financial constraints and under-funding. That said, many also expressed the opinion that the Charity Commission is best placed to provide this support, rather than the current options of charities paying for costly bespoke advice or remaining ignorant. For some interviewees, the fact remains that the requirement for advice still exists even if they are able to interpret and apply the information and written guidance from the Commission.

Participants from smaller charities generally required a more bespoke service than was available to them, currently relying on fellow trustees for expertise in areas where they may feel inadequately informed, recognising however that such advice may not be correct, or they may decide to proceed on ignorance. In such instances a few of the participating charities rely on specialised accountants or solicitors to fulfil this particular need. This was substantiated by the specialist accounting firms interviewed within this current work, who also stated that they were pleased to fulfil this role, since this form of relationship could be mutually beneficial for both the accounting firm and the charity.

Of those research participants who are regulatory aware, one of the common factors stated during the interviews which affected compliance with the regulations was that of cost. For large, sufficiently resourced, international charities, due diligence procedures were more likely to be embedded within the organisation and the attendant costs accepted as an operational necessity. Even these larger charities find the cost and resourcing of compliance onerous and consider that such resources could be better utilised within the scope of their organisational objectives.

A related dilemma faced by smaller charities focusing on higher risk areas was the delicate balance between fulfilling their charitable objectives and compliance with the regulation. Some in this group were unaware of the full extent of their regulatory responsibilities and clearly require further education, information and assistance in this regard. Others, however, though clearly aware of the due diligence requirements, were driven by a moral imperative to

pursue their mission regardless of whether they could comply. In these cases, following on from Walker's recommendations, this current research also concludes that this group of charities should be supported to manage the dilemma they face in completing their mission, but to do so in a regulatory compliant manner.¹² The alternative may be to expose the most vulnerable to the influence of terrorist organisations and 'worsen the generation of terrorism'.¹³

Another direct effect of the need for regulatory compliance is the necessity for additional skills and expertise amongst senior office holders within charities. This research identified that a lack of skill and expertise in the regulations on boards of directors combined with a more generalised low financial awareness, has a direct impact on the focus on compliance. A more professional approach to the trustee role may also be required to increase awareness of their responsibilities. Although an information pack is available to trustees, this consists of only eight pages which many had not even read.¹⁴ Compulsory training may therefore be necessary to provide confidence in the role and promote compliance. The question remains as to where such training should be obtained and who should provide and fund this activity?

The potential for over-reliance on good-will and trust amongst faith charities is also apparent from the research analysis, depending particularly on the trusting relationships between those of the same faith between donors, partners and eventual beneficiaries. Since charities are required to use risk-based assessment for the level of due diligence, in some cases this trust may fulfil this requirement, but the fact remains that such faith charities who solely rely on trust could be vulnerable to exploitation, exposing trustees to legal action and the charity to reputational damage.

¹² Clive Walker, 'Terrorism Financing and the Governance of Charities' in King, Walker and Gurulé (eds), *The Palgrave Handbook of Criminal and Terrorism Financing Law* (Palgrave 2018) 1105.

¹³ *ibid*: See also Emile Van der Does de Willebois, 'Nonprofit Organizations and the Combating of Terrorism Financing: A Proportionate Response' (World Bank Working Paper 208, 2010) 21.

¹⁴ Charity Commission, 'Trustee Welcome Pack' (30 April 2018).

As a direct consequence of the regulatory approaches by the Charity Commission, the research suggests a perception that Muslim charities are being unfairly targeted for regulatory focus. The press was found to also partake in biased reporting in this regard with sensationalist reporting causing considerable reputational damage to one of the interviewed charities in particular. The research identified that Muslim charities responded by either investing valuable resources in overtly demonstrating compliance, or exist in isolation, having no support network and struggling to understand what is expected of them. This concurs with other reported comment of a lack of central organisation amongst Muslim charities, and that many are not properly represented.¹⁵ The umbrella organisation Muslim Charities Forum, for example, currently has fifteen members,¹⁶ representing only a very small percentage of the total who may be identified as Muslim charities. There should perhaps be greater recognition of the huge contribution of Muslim charities to causes both in the UK and abroad and an understanding of the religious and the moral imperative driving donations which may require a more tailored approach.

In the wider context, many participants expressed a desire for a more positive presentation of what they do, in addition to greater support, and most who expressed a view considered that this role of championing the sector should fall to the Commission. There was, however, much criticism of the approach currently taken which was perceived by many to be inadequate. Perceived shortcomings included failure to counter negative press reports, particularly when no wrongdoing had been established, and failure to counter negative messaging more generally. There was little support amongst participants for splitting the roles of guidance provision and regulation of the sector. However, the myriad of specialist umbrella bodies should be rationalised, as this caused confusion and wasted resources, particularly as many such bodies are charities themselves.

¹⁵ For example see 'Muslim Charities: A Question of Identity' (*Third Sector*, 24 October 2014) <https://www.thirdsector.co.uk/muslim-charities-question-identity/governance/article/1317839> accessed 1 March 2020.

¹⁶ Muslim Charities Forum, 'Our Members' <https://www.muslimcharitiesforum.org.uk/our-member/> accessed 1 March 2020.

Any matters of financial irregularity and a lack of transparency are potentially very damaging to the sector. The specific requirements of counter-terrorist finance regulation may not be of immediate concern to many charities, however even where terrorist financing risks are deemed to be low, effective due diligence may improve understanding of financial flows and improve resilience against other financial irregularities. The current research suggests that it may be the medium-sized charities who face the greatest challenges with compliance. It is also evident that the Charity Commission identifies charities as being at greater risk of abuse for terrorist financing purposes in order to offer training. This may not meet the needs of the individual charity; therefore, a more targeted approach may be necessary.

The Charity Commission is responsible for policy promoting good governance and transparency. Promoting awareness of terrorist financing risks, and the need to assess such risks, as well as conducting the relevant due diligence should feature more prominently in any such policies.

3. INDIRECT EFFECTS OF THE REGULATION ON THE DOMESTIC CHARITY SECTOR

The indirect effects of regulation which have been discussed in this thesis relate to the unintended consequences flowing from implementation of the regulatory framework of bodies associated with charitable organisations. The interpretation of the requirements frequently leads to changes in behaviour of organisations such as banks; a direct effect of the regulation for banks and other financial service providers may thus exert an indirect effect on charities. The indirect approach is generally difficult to quantify, and one that policy may not tackle; it is often not subject to discussion and may also display prejudice. Policies aimed at tackling indirect effects of regulation may also be difficult to implement. They may require input and engagement from disparate groups of stakeholders who may not be accustomed to working together. Indirect effects, however, may often have a greater impact on individual charities than the direct

effects. The advantage of qualitative research is that these opinions from various stakeholders can be surfaced.

Responsibility for implementing the regulation has devolved to a significant extent to the banking sector, as financial intelligence is now a vital component of counter-terrorist finance strategy, and banks are key partners in the implementation of sanctions regimes. Financial institutions such as banks are operating in an increasingly harsh regulatory environment. As such, the banking sector is becoming increasingly risk averse and their subsequent behaviours, as a direct result of the regulation, has had significant indirect effects on some of their clients within the charity sector.¹⁷

The requirement for financial institutions to report suspicious activity and maintain rigorous due diligence procedures has resulted in high compliance costs, and a more circumspect approach. Regulatory failures by international banks have resulted in substantial fines both in the UK and abroad, which has also served to dampen risk appetite.¹⁸ Indirect effects may also be exerted from outside the jurisdiction. As the majority of UK-based banks also operate overseas, US dollar payments, for example, initiated and destined for outside the US, are nevertheless cleared via the US banking system and subject to US regulation regarding sanctions.¹⁹ Participants from the banking sector noted the powerful influence of the threat to withdraw dollar clearance from banks by US regulators. This may indirectly influence decisions made by UK banks with respect to risk, and with whom they may choose to end their relationships, if deemed too risky.

The data analysis revealed that many charities were experiencing challenges with respect to their relationship with providers of banking services which affected their operations to a significant degree. These included; lack of direct

¹⁷ David Artingstall and others 'Drivers and Impacts of de-risking' Commissioned by the Financial Conduct Authority, February 2016.

¹⁸ Chapter Five s.5.1.1-5.3.

¹⁹ Charity Finance Group, 'Written Evidence Submission: Home Affairs Select Committee-Counter-terrorism Inquiry' September 2013.

debit provision; difficulties in banking cash; problems arising from their use of Money Service Businesses and bank account closures. From the charity participants' perspective, failure to engage with them and repeated requests for information for which there was no discernible purpose, as well as intrusive checks were impediments to good banking relationships. Where collaborative relationships existed, the mission of charities reported were varied and included charities which sent funds to conflict areas. The difference here lay in the relationships fostered between the organisations. Other successful relationships included major charities where the relationship was clearly mutually beneficial.

An element of prejudice, as mentioned above, as a result of indirect effects of the regulation has been noted by participants in relation to Muslim charities. This concurs with the recent observation by Keatinge that domestic Muslim humanitarian charities in particular have been affected by financial restrictions imposed by banks.²⁰ Some participants reported a belief that this selective targeting may be associated with historic abuses that have received attention and cast a veil of suspicion over all Muslim organisations. Again, the question of lack of positive messaging from the Charity Commission and the failure of banks to give an explanation when bank accounts were closed for no apparent reason, was raised in this regard. The damage caused by such action was considered by some participants to be particularly acute for Muslim charities as it appeared to reinforce the notion that charities were involved in financing terrorism. This research has identified issues with prejudice against Muslim charities which need to be addressed by the Charity Commission, not only from within but also with respect to countering outside messaging. This could involve providing additional support to umbrella bodies supporting the Muslim charity sector with encouragement to individual charities to join.

Communication between individuals in the charity and banking sectors was cited as an issue by participants from both sectors, with both citing the other as

²⁰ Tom Keatinge and Florence Keen, 'Humanitarian Action and Non-state Armed Groups: The Impact of Banking restrictions on UK NGOs' (Chatham House, 2017) 3.

lacking in understanding of their requirements. Several charity participants as well as other third-party stakeholders, including accountants and solicitors recognised that there were additional measures that charities could take to increase confidence in them from the banks' perspective. These included communicating their financial strategy with the bank which also reflects their values, demonstrating that there are rigorous financial controls in place, the provision of audit trails and demonstrating compliance with regulation with respect to financial accounting and a track record of stability as well as effective and efficient administration. Participants from banks were particularly nervous when confronted with poor client accounting practices. There should be collaboration between the sectors, which could also include experts from the accounting profession to develop a standardised screen-based accounting system which could provide the information that the bank requires in standard form and obviate the need for continuous requests for information, which are poorly understood.

Banks, as commercial enterprises, can choose their clients, and indeed have chosen, as evidenced in many well-publicised cases, to de-risk and withdraw their services from some.²¹ Their clients have to understand this commercial reality. The scale at which this is happening is difficult to assess as many charities, according to several participants, would prefer not to publicise an account closure. Delayed transactions and bank closures caused damaging reputational risk and reduced donor confidence, which many participants actively sought to avoid. Charities may therefore seek to maintain several accounts with different banks as an insurance against this happening. Many of the participants, particularly those from humanitarian charities operating in unstable geographical areas though, recognised the need for transparency in their financial dealings opposite their financial service providers, and were acutely aware of the consequences of losing the confidence of the bank.

²¹ For example, the UK charity Upendo and the Ummah Welfare Trust. For details see Chapter Seven s.5.2.

From the perspective of several of the charity participants, the banks have little understanding of their operating environment and how their risks are managed within the organisation. Some, however, reported being able to work with the bank to successfully deliver aid to unstable areas, whereas others were less successful, having to curtail projects which would have more closely fulfilled their charitable aims and divert resources elsewhere. There is clearly an opportunity for charities to share experiences, which could be co-ordinated by bodies such as the Charity Commission had they sufficient capacity to do this.

There is therefore much that individual charities could do to improve the transparency of their financial flows. Enhanced financial training for trustees and other office holders within charitable institutions, and a more comprehensive support structure, which could be provided by third-party advisors or the Charity Commission, may help to increase the confidence with which financial matters are approached. There is also a need for further research to investigate the costs to charities of compliance with due diligence requirements and the demands placed upon charities by banks for additional compliance-based information. With this further insight, it may be possible to create a greater understanding between charities and their financial services providers.

It is clear however, that in order to deliver aid to some of the most vulnerable, some charities will require outside assistance. The government has stated its policy commitment to providing humanitarian assistance to areas affected by conflict such as Syria.²² They should therefore be doing more to support organisations whose aim is to do this. Participants reported difficulties in delivering projects due to sanctions regimes, which is an area in which government intervention could assist. Although exemptions for the delivery of humanitarian aid in areas affected by international sanctions may exist, many banks are uncomfortable with this, and licenses are therefore needed where

²² For example, see Department for International Development, 'UK Aid pledges "Vital Lifeline" for Syria' 9 (Press release, March 2019) <https://www.gov.uk/government/news/uk-aid-pledges-vital-lifeline-for-syrians> accessed 1 March 2020.

exemptions do not exist. General licenses may be a solution, but these could only be appropriate where there was sufficient expertise within the charity to deliver aid safely and legally. The Charity Commission could take the lead in certifying certain charities based on expertise and track record. This may mean, however, that other entities are unable to operate. The research has identified that for some there is a moral imperative to deliver their charitable objective whether or not this meets regulatory requirements. Such entities may be persuaded to come under the umbrella of a certified charity in order to deliver services in a more controlled manner.

Charities operating in an environment without access to banking facilities may have no alternative but to use less secure means of transferring funds. These higher risk transfer vehicles, for example, hawala and cash couriers are beyond the reach of regulation that exists within the banking and other financial services sectors. With this increased volume of traffic in the 'grey sector' it becomes easier to lose less ethical transactions to the supply chain. The question then needs to be asked, how can we maintain, and even increase the flow of financial information in an ethical way so that it can be used by law enforcement agencies? The answer does not lie in allowing the closure of bank accounts for charities, nor to the restriction of financial access to sections of the community. This stance is not congruent with the overall purpose of the counter-terrorist finance regulation. Financial institutions should be encouraged and supported in the retention of clients, firstly because the alternative for clients without access to banking facilities is contrary to the aims of the regulation and secondly because for every bank account, there is the potential for useful financial information to be gathered and analysed, and thus provide valuable intelligence. The potential to gather intelligence is surely preferable to losing this potential and diverting funds to a secondary provider, who may be operating beyond the reach of regulators.

Other solutions should also be explored: blockchain technology, for example, as a means of transferring funds from donor to charity, and onwards to the

intended beneficiaries, with the potential advantage of increased transparency of financial flows.²³

With respect to messaging and the vulnerability of the sector to abuse, which has had far-reaching negative consequences, there have been some positive developments. The FATF Recommendation 8 has been modified and reference to NPOs particular vulnerability to abuse removed,²⁴ which involved the long-overdue engagement with the NPO sector. With seats on the FATF platform they have an opportunity to influence policy and to bring this and other issues affecting NPOs to a wider audience. Whether this change can reverse the negative impact that it has had on the non-profit sector, remains to be seen. The experiences of many of the charity sector participants suggest that the spectre of financial restrictions continue to threaten them, and they do not see any prospect that this will change in the near future. As a policy issue, the Government should promote the increased involvement of those with an interest in the sector, who also have a firm understanding of the challenges it faces. The challenges facing NPOs need to be brought more forcefully to the attention of this hugely influential body: essential if this situation is to change. At a national level there is also friction between government departments, and a tension between the aims of the sanctions regime and delivering humanitarian aid, often in areas where there is political instability and a failed banking system, but also where the need may be greatest.

There are significant areas where deficiencies have been identified and recommendations for addressing these have been made. The Charity Commission is clearly not equipped to fulfil the multiple roles that this research concludes should fall within its remit. However, this could be possible if sufficient funds were made available.

However, there is also a need for a wider conversation to take place. Recommendations from international bodies or regulatory decisions are not

²³ See Chapter Six s.2.7.

²⁴ Romaniuk and Keatinge (n 2).

about individual policy, nor are they taken in isolation, but are influenced by the constantly changing behaviours of terrorists within an environment that is constantly changing. The research has identified some of the individual stakeholder responses to this dynamic environment which could affect the entire ecosystem. Financial regulators may respond to incidences of terrorist financing by taking a more punitive approach towards banks;²⁵ banks in response may adopt a risk-averse strategy toward charities.²⁶ The behaviour of charities toward the regulation may be influenced by guidance provided by the Charity Commission/other third parties²⁷ and lack of guidance, or acceptance of the risk in order to pursue their objectives, may increase the risk of funding terrorist activity.²⁸ The perceived control that the Charity Commission has over the sector may also influence the banks' assessment of risk with respect to charity clients.²⁹

This research has thus identified a paradoxical interconnectivity between the pivotal structures. For example, one of the core purposes of the Charity Commission is to enable and facilitate the delivery of charitable purpose. In compliance with the counter-terrorist finance legal framework the Charity Commission is also required to monitor and enforce compliance by charities. Thus, enforcing the regulation could result in constraining the activity of charities, which would conflict with its enabling principal. Similarly, a core role of financial regulators is to facilitate financial transactions in a transparent manner. However, the regulations require stringent monitoring and control of these transactions, with severe consequences for regulatory breach, which may result in decisions to avoid the risk of providing services to entities such as charities. As a result of this risk aversion charities may avoid the regulated banking system and turn to less transparent modes of transferring and storing funds.

²⁵ Chapter Four s.5.

²⁶ *ibid.*

²⁷ Chapter Eight ss.3-4.

²⁸ Chapter Six s.4.1,4.3.

²⁹ Chapter Eight s.4.3.

Policy makers therefore should consider whether the behaviours that the regulation is aiming to create are actually being achieved. The regulation should be viewed less through the lens of compliance, judging whether organisations are compliant or non-compliant, and more through the lens of effectiveness of implementation. Banks are not in a position to do this themselves: a partnership approach that is supportive and enabling rather than punitive is required, therefore dialogue between stakeholders is essential in order to find a way through. Until this happens it is charities and their potential beneficiaries who pay the price. Thus, there needs to be a wider conversation taking place, with a responsible body to curate this conversation: to manage the relationships and the dynamic within this constantly changing environment in which the counter-terrorist finance regulation, the charity sector, financial services sector and their regulators converge. It is suggested that this a role for HM Treasury department, with the authority to make policy decisions with respect to the interpretation of FATF recommendations and to require input from both charities and financial institutions.

The domestic charity sector fulfils an essential function within society, which is reliant to a great extent on donor confidence. Weak and ineffective compliance has to be addressed and charities clearly require support to ensure meaningful, effective and proportionate regulatory compliance. Furthermore, relationships need to be managed to ensure that the negative effects of the counter-terrorist finance regulation do not impact on their ability to fulfil their charitable purpose to the detriment of our society.

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Appendix A: List of Participants

	Date of Interview	Description
1	10 August 2017	Trustee: Medium-sized charity
2	11 August 2017	Trustee: Medium-sized charity
3	20 August 2017	Trustee: Medium-sized charity (Regional branch of national organisation)
4	23 August 2017	Head of Policy: Umbrella organisation
5	8 September 2017	Trustee: Large-sized charity (Regional branch of national organisation)
6	22 September 2017	Trustee: Medium-sized local faith charity
7	29 September 2017	Two representatives: Super major-sized international faith charity
8	10 October 2017	Two representatives: The Charity Commission for England and Wales
9	10 October 2017	CEO: Large-sized national charity
10	14 November 2017	Trustee: Large-sized charity
11	16 November 2017	Representative: Umbrella-type organisation
12	20 November 2017	Solicitor/Trustee and representative of local charity umbrella group
13	4 December 2017	Finance Director: Major-sized international faith charity
14	18 December 2017	Executive Director: Medium-sized international faith charity
15	19 December 2017	Finance Director: Medium-sized international faith charity
16	1 February 2018	Trustee: Large-sized international charity
17	16 February 2018	Compliance officer: International bank
18	1 April 2018	Trustee: Large-sized charity (Regional branch of national organisation)
19	17 April 2018	Trustee: Micro-sized local charity
20	3 May 2018	CEO - Large national charity
21	9 May 2018	Trustee: Medium-sized faith charity
22	12 May 2018	Trustee: Small-sized faith charity
23	18 May 2018	Trustee: Medium-sized charity (Regional branch of national organisation)
24	22 May 2018	Director: Medium-sized charity
25	29 May 2018	Representative: Umbrella organisation
26	8 June 2018	CEO: Super major-sized charity
27	15 June 2018	Trustee: Major-sized international charity
28	18 June 2018	CEO: Major-sized international charity
29	20 June 2018	Accountant: Specialist in charity accounting
30	9 July 2018	Accountant
31	10 July 2018	Trustee: Small-sized local charity
32	5 September 2018	Compliance Director: International Money Service Business
33	15 October 2018	Representative from local branch of international bank
34	23 November 2018	Representative from Head Office of large international bank

Appendix B: Notice of Ethical Approval



School of Law and Social Justice Committee on Research Ethics

8 June 2017

Dear Dr Sigafoos,

I am pleased to inform you that your application for research ethics approval has been approved. Details and conditions of the approval can be found below:

Reference: 1897
Project Title: A Critical Exploration of the Impact of Counter-terrorist Finance Regulation on Domestic Charities
Principal Investigator/Supervisor: Dr Jennifer Sigafoos
Co-Investigator(s): Ms Angela Fowler
Lead Student Investigator: -
Department: Law
Reviewers: Dr Christine Schwobel-Patel, Ms Lucy Yeatman
Approval Date: 08/06/2017
Approval Expiry Date: Five years from the approval date listed above

The application was APPROVED subject to the following conditions:

Conditions

- Please note the Reviewers Comments which have been attached to your application in the portal.
- All serious adverse events must be reported via the Research Integrity and Ethics Team (ethics@liverpool.ac.uk) within 24 hours of their occurrence.
- If you wish to extend the duration of the study beyond the research ethics approval expiry date listed above, a new application should be submitted.
- If you wish to make an amendment to the research, please create and submit an amendment form using the research ethics system.
- If the named Principal Investigator or Supervisor leaves the employment of the University during the course of this approval, the approval will lapse. Therefore it will be necessary to create and submit an amendment form using the research ethics system.
- It is the responsibility of the Principal Investigator/Supervisor to inform all the investigators of the terms of the approval.

Kind regards,

School of Law and Social Justice Committee on Research Ethics
lsjethic@liverpool.ac.uk

Appendix C: Topic Guide for Participants from the Charity Sector

1. Understanding of the counter-terrorist finance legal framework

- Awareness and understanding of the legal framework within the organisation and the charity sector (Explanation of the legal framework provided if necessary).
- The elements of the requirements considered as particularly relevant to the organisation.

2. Implementation of the legal requirements

- The processes in place (if any) to meet the legal requirements.
- The adoption of any new systems to automate compliance (finance systems/audit/anti-diversion or other compliance systems).
- The use of screening software.
- Risk assessment policies.

3. Implications for the organisation

- General experience of implementation (acceptance/resistance).
- Positive effects of implementation (possible example-donor confidence).
- Factors limiting compliance.
- How the regulation is viewed.
- Suggestions for improvement.
- Recent amendment to Financial Action Task Force Recommendation 8. Implications for the sector?

4. Engagement with third parties

- The Charity Commission - as regulator and advisor.
- Guidance provided by Charity Commission regarding counter-terrorist financing/generally.
- Other sources of advice/guidance - Engagement with auditors/accountants/solicitor/umbrella bodies.
- Relationship with financial service providers- Specific challenges encountered (unusual document requests/delays in transfer of funds/account closures/refusal to open bank accounts).

Appendix D: Topic Guide for the Charity Commission

1. Understanding of the counter-terrorist finance legal framework

- Awareness and understanding of the legal framework within the charity sector generally.
- Elements of the requirements considered as particularly relevant to charities.

2. Implementation of the legal requirements within the Commission

- The processes in place to meet the legal requirements.
- View of whether sector adopting new systems to automate compliance (finance systems/audit/anti-diversion or other compliance systems).
- The use of screening software.
- Risk assessment policies.

3. Implications for the sector

- General experience of implementation (acceptance/resistance).
- Positive effects of implementation.
- How the regulation is viewed.
- Suggestions for improvement.
- Discussion of recent amendment to Financial Action Task Force Recommendation 8 and implications for the charity sector.

4. Engagement with charities

- The Charity Commission- role both as regulator and advisor.
- Guidance provided by Charity Commission regarding counter-terrorist financing.
- View on third-party advice givers.
- Engagement of charities with banks.

Appendix E: Topic Guide for Participants from Financial Institutions

1. Understanding of the counter-terrorist finance legal framework

- Awareness and understanding of the legal framework within the organisation and the charity sector.
- The elements of the requirements considered as particularly relevant to the organisation.

2. Implementation of the legal requirements

- The processes in place (if any) to meet the legal requirements.
- The adoption of any new systems to automate compliance (finance systems/audit/anti-diversion or other compliance systems).
- The use of screening software.
- Risk assessment policies.

3. Implications for the organisation

- General experience of implementation (acceptance/resistance).
- Positive effects of implementation.
- Factors limiting compliance.
- How the regulation is viewed.
- Suggestions for improvement.

4. Engagement with Charities/ Umbrella bodies

- Recent amendment to FATF Recommendation 8- Implications for relationship with charity sector.
- Understanding of the sector/specific challenges encountered.
- Risk mitigation.