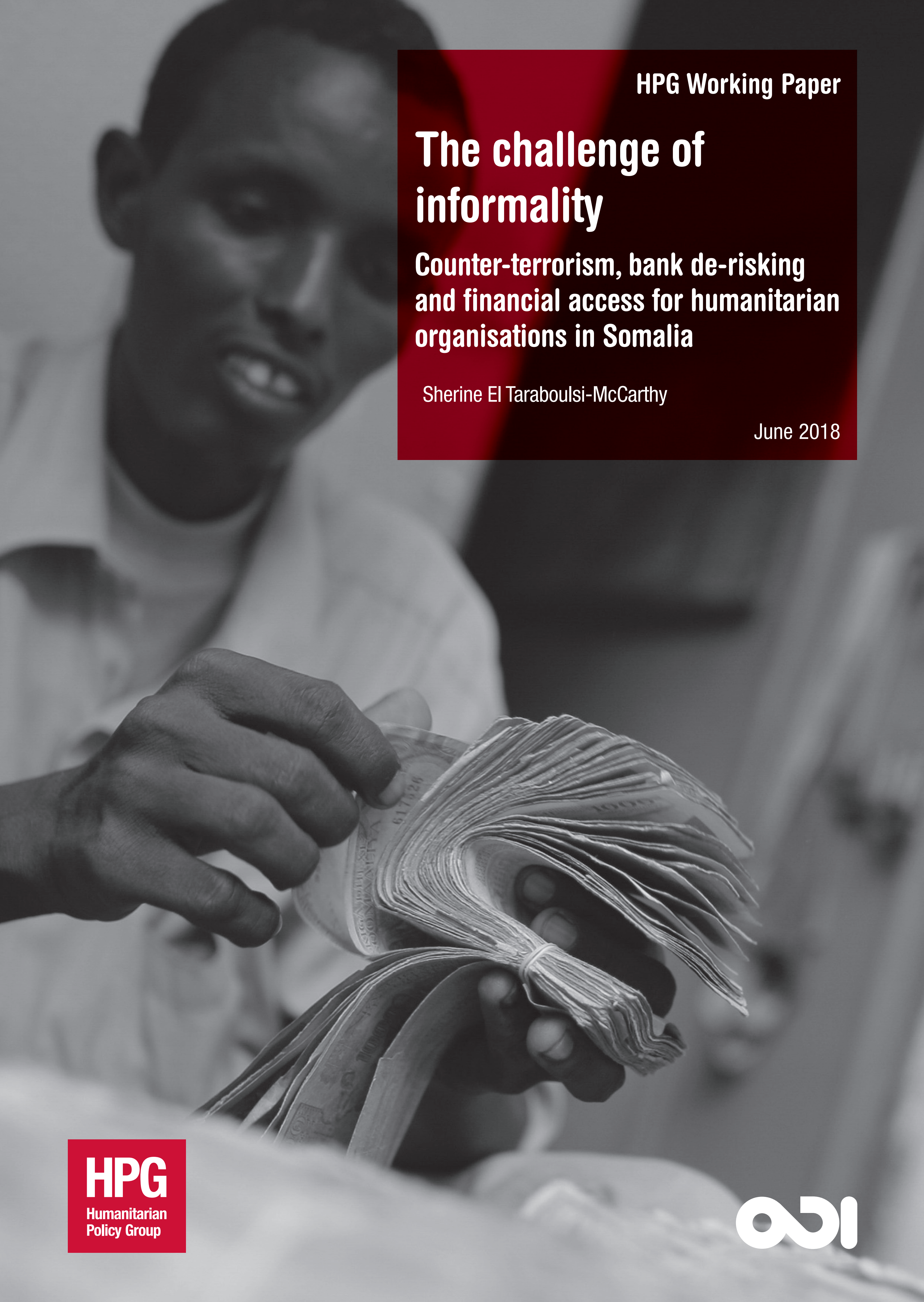

HPG Working Paper

The challenge of informality

Counter-terrorism, bank de-risking and financial access for humanitarian organisations in Somalia

Sherine El Taraboulsi-McCarthy

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Humanitarian Policy Group

About the author

Sherine El Taraboulsi-McCarthy is a Research Fellow with the Humanitarian Policy Group (HPG) at the Overseas Development Institute (ODI).

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Humanitarian Policy Group
Overseas Development Institute
203 Blackfriars Road
London SE1 8NJ
United Kingdom

Tel. +44 (0) 20 7922 0300
Fax. +44 (0) 20 7922 0399
Email: hpgadmin@odi.org
Website: http://www.odi.org/hpg

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Executive summary

Somalia's financial sector is not a centralised system with clear checks and balances. Instead, it operates through various formal, less formal and informal actors, including three central banks (in Somaliland, Somalia and Puntland), money transfer operators (known locally as *hawala*) with international bank accounts, mobile money operators tied to the private sector and informal money transfer businesses operating locally. The financial sector faces both internal and external challenges, all of which have important implications for local humanitarian actors. Internally, the financial sector is stuck between dominant private money transfer companies and a small and relatively weak formal banking sector. External challenges stem largely from the enforcement of counter-terrorism measures and banking regulations, which has seen transactions delayed or frozen and bank accounts closed.

For local humanitarian organisations, these de-risking measures make it difficult to receive transactions through the formal banking system in a timely manner. They also block money transfer operators as a viable channel for financial access and the transfer of remittances from the Somali diaspora. For the local humanitarian sector to survive, systemic and structural shifts need to be put in place to ensure transparency within the financial system, and open up channels for financial access for local humanitarian actors. Interviews with bankers, humanitarian actors and academics for this study point to the following:

- Money transfer companies, mobile money and other means of financial transactions outside the formal banking system are essential to the humanitarian response in Somalia.
- The popularity of money transfer operators may have contributed to the weakening of the Central Bank of Somalia, which has had no oversight over money transfer businesses.
- Some local money transfer businesses have questionable transparency measures and have contributed to aid diversion, but the majority of local and international operators have rigorous Know Your Customer (KYC) measures in place.
- Some international organisations have stopped using money transfer operators in order to support more financial/aid transparency, but this means that many local humanitarian organisations are not able to use these funds because they do not have access to bank accounts.

The study calls for more long-term support from international humanitarian actors as well as financial regulators in the US and Europe for Somalia's financial and humanitarian sectors. It urges the various actors involved to manage risk, rather than trying to avoid it, working with formal, less formal and informal financial actors in Somalia to ensure financial access for humanitarian actors, and to create incentives for informal financial actors to submit to more regulation and join the formal financial sector. The study's overarching recommendation is the urgent need to support Somalia's financial sector to facilitate much-needed humanitarian assistance and remittances, while also reducing financing for violent extremism. This will require investing in the country's financial infrastructure, as well as rethinking the utility of the counter-terrorism regime.

1 Introduction

Following the events of 11 September 2001, many countries adopted strict Anti-Money Laundering and Combatting the Financing of Terror (AML-CFT) regulations for fund transfers. According to a study for the Financial Conduct Authority (FCA) in the UK, these requirements 'include prudential and conduct obligations and standards as well as the threat of enforcement action for failing to meet such obligations, particularly in relation to anti-money laundering/ combatting financing of terrorism' (Artingstall et al., 2016: 5). This process – known as 'de-risking' – has increased the overall cost of complying with regulatory requirements.[1] The cost of non-compliance is also high; in 2012, HSBC was fined $1.9 billion for not complying with money laundering controls (Plaza, 2014). Global counter-terrorism and anti-money laundering measures, while seeking to control these threats, has created a situation where, as Keatinge (2014: 15) describes it, 'measures imposed by banks in meeting these obligations often have far-reaching and unintended consequences. They can impact the innocent and the guilty in equal measure. While the latter often adapt, the former have to learn to live with the extra checks, delays in transaction execution, and general frustration of increased bureaucracy'.

As a result of these regulations, several banks in the US and the UK have closed the accounts of Somali money transfer operators (MTOs). In 2013, for instance, British bank Barclays closed the accounts of over 200 clients operating money service businesses (Keatinge, 2014: 16). In the majority of cases, banks have provided their customers with no detailed explanation as to why banking services have been withdrawn. These measures have adversely affected Somali money businesses, and individual Somalis face difficulties in making or receiving transactions through Somali bank accounts. Restrictions on financial access have also had serious implications for local responses to the humanitarian crisis in Somalia. NGOs have had to look for alternative channels to secure financial access, some of which may be less formal and less transparent than existing MTOs.

Somali MTOs are critical to financial transfers to Somalia, whether in the form of remittances from the diaspora to their communities in Somalia or in the form of transfers to local humanitarian organisations. Remittances account for between 25% and 45% of Somalia's economy, exceeding the amount the country receives in humanitarian aid and foreign direct investment combined (Adeso et al., 2015). As Somali money transfer operators have lost their bank accounts, so families in Somalia have lost the main channel through which to send money (Adeso et al., 2015).

This study explores the implications of bank de-risking for the local humanitarian sector in Somalia. Its point of departure is the recognition of the connection between local humanitarian response and financial access, locally, regionally and globally. As one respondent in the study put it: 'If we want the humanitarian sector to work well, we need a banking sector in Somalia'.[2] Another described how banking is essential to business, and in turn to creating livelihood opportunities for Somalis and facilitating a transition from humanitarian response to recovery. A functioning banking sector will give a more 'secure footing'[3] for businesses by providing them with access to international financial services.

The study's findings are based on a review of the literature on counter-terrorism and de-risking in conflict zones, the financial sector in Somalia and two rounds of interviews. The first round, organised by the Humanitarian Forum in Mogadishu in May 2017, included a consultative workshop, focus group discussions and in-depth interviews. Seventeen participants from 12 NGOs and two local banks attended the consultative workshop and focus group

1 De-risking refers to actions by banks to avoid business and reputational risks under counter-terrorism regulations. More broadly, it is used to refer to the withdrawal of financial services, products or relationships in response to concerns around money laundering and terrorist financing (SWIFT, 2016). One consequence of de-risking is that it excludes particular individuals and organisations from the financial system based on the degree to which they constitute a 'risk'.

2 Author interview, 8 November 2017.

3 Author interview, 20 December 2017.

discussions, and ten participants, five from NGOs and five from local banks, took part in the in-depth interviews. The second round was conducted by the Overseas Development Institute (ODI) in 2018. It featured 20 in-depth, semi-structured interviews with MTOs, bankers, humanitarians (Somali and international) and businesspeople. NGOs interviewed for the study were both faith- and non-faith-based. No firm, individual or business is named in the study. Efforts were made to verify information via different sources, to avoid bias either for or against the implications of bank de-risking in Somalia.

2 War, conflict and the humanitarian response

The roots of Somalia's humanitarian crisis lie in a combination of political crisis and natural disasters. The country has been through various forms of civil war and armed conflict since 1988. Following the collapse of the state in 1990, Somalia was reconfigured demographically and politically into three main areas: Somaliland in the north-west, Puntland in the north-east and South-Central Somalia to the south (El Taraboulsi et al., 2017: 15). Between 1991 and 2012 the country had no functioning central government, earning it 'a perennial spot at or near the top of rankings of the world's most failed or fragile states' (Menkhaus, 2013: 134). Conflict between the forces of the Federal Government of Somalia (FGS), assisted by peacekeeping troops from the African Union, and the Islamic group Al-Shabaab is concentrated in southern Somalia.

Somalia's long history of conflict means that Somalis under the age of 35 (who constitute about three-quarters of the population) barely have any memory of a functioning Somali state (Menkhaus, 2013: 134). Menkhaus paints a bleak picture of the country's political crisis:

> *The government has been paralyzed by the in-fighting and delivers virtually no services to its people. Levels of corruption are legendary. Government security forces are essentially independent paramilitaries answering to clan militia leaders. A secessionist state, Somaliland, with a population of perhaps three million (out of a total number of Somali speakers worldwide thought to be about twenty million) refuses to have anything to do with the elections of the government* (Menkhaus, 2013: 134).

This breakdown of governance has coincided with endemic natural hazards and disasters affecting millions of people every year. According to the UN Office for the Coordination of Humanitarian Affairs (OCHA), by July 2017 more than half the population was in need of humanitarian assistance, with a persistent threat of famine and emergency levels of malnutrition in some areas of southern and central Somalia. By early September 2017, more than 975,000 people were internally displaced due to drought and conflict and reliant on humanitarian assistance to meet their basic needs. Another 1.1 million were in protracted displacement. More than 77,000 cholera cases and 1,100 deaths, and almost 16,000 measles cases, have been reported (OCHA, 2018).

Human rights violations are another significant problem. Abuses against civilians are endemic and perpetuate fear and insecurity. The FGS largely operates outside the formal judicial system, with the police, intelligence bodies and military courts arresting, detaining and sentencing suspects – children included – without fair trial (Human Rights Watch, 2017). In 2013, the FGS adopted a UN-sponsored Human Rights Road Map within the framework of the Somali Compact development plan for 2014–16, but adherence to human rights standards remains largely nominal and the FGS still lacks a national mechanism to provide redress for violations and abuses (OHCHR, 2008; UNSOM, 2018). Amnesty International (2016) has registered more than 50,000 civilian deaths through executions, extrajudicial killings, crossfire and targeted and indirect attacks by all parties to the conflict. Conscription and recruitment of children has been recorded on all sides of the conflict, sexual and gender-based violence is rampant and IDPs are subject to forced evictions, sexual exploitation and violence, with little or no access to humanitarian assistance (OHCHR, 2008; Amnesty International, 2016; Human Rights Watch, 2017). Civilians have also been caught up in airstrikes and ground operations by forces deployed under the African Union Mission in Somalia (AMISOM).

Humanitarian access is a major challenge. During the drought of 2011, Al-Shabaab directly attacked humanitarian actors, imposed aid blockades in famine-affected territories and refused to let Somalis under its control flee drought areas (ICG, 2017). Humanitarian assistance has become 'highly politicised and fraught with security, reputational and fiduciary risks. Although Al-Shabaab has lost control of most of Somalia's urban centres, it is still present in many rural areas in the south of the country' (El Taraboulsi et al., 2017: 15). Humanitarian assistance was scaled up in 2017, with local and international humanitarian partners reaching more than three million people a month. The 2018 Humanitarian Response Plan (HRP), developed by the Somalia Humanitarian Country Team (HCT) in consultation with federal and state authorities, focuses on the provision of lifesaving assistance, reducing acute malnutrition, reinforcing protection services for affected communities and strengthening resilience (OCHA, 2018b).

Telecommunications and money transfer *(hawala)* enterprises have been critical to the humanitarian response, particularly cash programming, which has become a significant part of the drought response. Conditional and unconditional cash grants or vouchers are being used on a very large scale; in May 2017 alone, more than $48 million in cash reached more than three million people (OCHA, 2018b). Both Somali *hawala* and mobile money systems have provided reliable and low-cost channels to transfer money locally and internationally. The two largest companies in this field, Dahabshiil in Somaliland and Hormud in Mogadishu and the south, are perceived as monopolistic and politically influential; although there are other smaller companies in the sector, they struggle to compete with the big two (El Taraboulsi et al., 2017: 19). Both Dahabshiil and Hormud have their own charitable foundations. These operate according to their own informal mechanisms, relying on extensive informational and business networks (El Taraboulsi et al., 2017: 19).

3 Somalia's contradictory financial sector

Formal financial *institutions* are weak in Somalia, but financial *services* are available and, as one respondent put it, 'vibrant'. This seemingly contradictory reality is worthy of close examination, especially in light of its implications for the humanitarian sector in Somalia. Oversight by a centralised government entity is lacking, resulting in a decentralised financial sector providing a wide range of services, from informal cash transfers by money brokers to more formal money transfer businesses and traditional banking. More informal services are both more agile and more widely used than more formal, bureaucratic financial institutions.

Somalia started rebuilding its formal financial institutions with the establishment of the Federal Government in 2012. The country has also begun to normalise relations with international financial bodies, alongside a national development plan embodied in the Somali Compact (IMF, 2017). However, although the CBS has been re-established, staffed and funded, it 'has no control over either the exchange rate or the supply of the Somali shilling'. Moreover, '[it] has not issued any banknotes since 1991, resulting in a largely dollarized economy' (IMF, 2017: 8). The financial sector is effectively stuck between the dominant money transfer companies and a small and relatively weak banking sector. It is also fragmented, with separate central banks for Somaliland and Puntland, in addition to the CBS. Somali humanitarian actors are acutely aware of the failings of their financial sector; participants in the focus group discussion held for this study in Mogadishu in 2017 acknowledged that 'Somalia has no effective monetary system; the government is considered corrupt and the country is a failed state, struggling with terrorism'.

There have been efforts to strengthen the banking sector. In 2015, Standard Chartered Bank opened a branch at the UN complex in Gigiri to facilitate UN financial activities, with the aim of 'lower[ing] the risks and costs associated with handling cash, as well as simplifying and accelerating basic payment processes to help [UN staff] carry out essential humanitarian work in the field' (Standard Chartered, 2015). The World Food Programme (WFP) is working with Standard Chartered regarding agreements for secure transfers in order to scale up its cash response. Bangladesh-based Premier Bank has also opened in Somalia and Somaliland. In 2016, the World Bank launched the Somali Core Economic Institutions and Opportunities Program (SCORE), a $28.5 million project that is to be implemented across the Somali peninsula to develop legal, regulatory and policy frameworks for key Somali financial institutions and provide incentives for private investment and job creation. The project covers key institutions including the CBS, the Ministry of Commerce and Industry, the State Bank of Puntland and the Central Bank of Somaliland, as well as the ports at Mogadishu and Bosaso (Mohamed, 2017). To support the banking sector and to ensure that funds are not diverted, one international humanitarian organisation has set a requirement that all salary payments are made through bank accounts.[4]

The weakness of the formal financial sector is related to the general developmental challenges Somalia faces after more than 20 years of state collapse and violence. The UN Development Programme (UNDP)'s 2012 *Human Development Report* ranked Somalia among the five countries with the lowest Human Development Index (HDI), with poor access to health and education, wide gender gaps, widespread poverty affecting 82% of the population and rampant unemployment among young Somalis, who constitute more than 70% of the population (UNDP, 2012). The economy is largely informal, with its productive sectors – the war economy and the service sector – disconnected from the bulk of the population and mainly benefiting the commercial and military elite (Menkhaus, 2003; Tilmes, 2017). The disconnect between economic development at the top and the lack of development at the bottom, coupled with an economy driven by consumption and lacking

4 Author interview, 29 November 2017.

central regulations, has left a large proportion of the population financially incapable of meeting their needs. The spike in food prices that accompanied the famines of 2011 and 2016 exacerbated Somalis' vulnerability, rendering millions of people unable to cope with crises.

Somalia's informal economy is closely tied to remittances. UNDP (2012) estimates that remittances account for a third of the country's GDP. Money transfers from migrants have had a markedly stabilising effect in a very unstable context: 'They have been more consistent than aid, investment or social welfare programs … famine would have been declared long ago if not for money from the diaspora' (Paul, 2017). MTOs estimate that over 80% of the start-up capital for small businesses in Somalia is sent by the diaspora. Money received from abroad is also used to meet basic needs, including food, water, shelter and education, and most remittance recipients provide support to poorer relatives. According to a survey by the International Fund for Agricultural Development (IFAD), 60% of recipients in 2009 received remittances from the three largest companies in region: Dahabshiil, Amal Express and Qaran Express. An estimated 27% of transfers are made through informal networks in Somalia, less than in many other African countries, where informality exceeds 35% (Orozco and Yansura, 2013: 12).

3.1 Money transfer operators

In the longstanding absence of central financial institutions, MTOs within the *hawala* system have constituted the backbone of Somalia's informal financial system (Houssein, 2005), with Dahabshiil Financial Services Inc., Amal Express, Dalsan Trading and Towfiiq among the largest Somali companies. According to one respondent: '*Hawala* is the financial sector for Somalia; it is all over the country. There are about 20 *hawalas* in every town. You can find MTOs in villages and cities. They have offices all over the world. International funders don't always trust them but they partner with them'.[5]

While a substantial number of Somali MTOs have made efforts to comply with AML/CFT regulations and avoid bank de-risking, most international banks view them as high-risk customers. Funds transferred to and from MTOs as well as from and to Somali bank accounts are usually delayed or blocked without explanation. Many banks, especially in the US, have closed MTO accounts, making it very difficult for MTOs to maintain their operations and for Somalis to send remittances to Somalia. Somali-American MTOs have struggled to find banks willing to open accounts for them, and even small financial institutions have closed Somali-American MTO bank accounts (Orozco and Yansura, 2013: 19). Limited access to banking services and the increasing costs of compliance have cut into MTOs' profits and limited their ability to expand their services and coverage (Adeso et al., 2015).

International humanitarian organisations have warned against the de-risking of Somali MTOs, arguing that the loss of banking arrangements may reduce remittances to Somalia and force funding flows underground, encouraging the growth of informal business and criminal networks (and thereby defeating the primary objectives of AML/CFT regulations). Scott Paul, Humanitarian Policy Lead at Oxfam America, warns that:

> *MTOs are often the only remittance option for many poor migrants and their families who have no other point of access to the formal financial sector. MTOs themselves typically rely on banks to provide financial services such as check collection, deposit services, payroll services and most critically, wire transfers as well as for their typically more robust anti-money laundering/combating the financing of terrorism (AML/CFT) information technology infrastructure. MTOs rely on cross-border wires in order to settle its accounts. If an MTO is unable to access this service in a country where it sends or receives money, it will be forced to identify another way to move money in or out of the jurisdiction and otherwise may shut down its operations there* (Paul, 2017).

MTOs are yet to be regulated by the CBS and oversight of their activities is inadequate. One Somali risk consultant described the problem as follows:[6]

> *Consider the following scenario: NGO A contracts supplier B to build a refugee camp. Both have identification numbers. Money is transferred from account A to account B via the hawala system, and NGO A is given*

5 Author interview, 28 November 2017.

6 Author interview, December 2017.

a receipt from the money company that the transaction has been made. The reality is this: No one can really establish the authenticity of the transfer, and neither can you establish the authenticity of the supplier. The records cannot be verified. Money transfer businesses are so decentralized; in rural areas, in particular, their work is based on trust and they can give you whatever document you may require. In the end, statements from money transfer companies cannot be authenticated.

There is a distinction to be made between MTOs that operate locally and those that operate internationally. For MTOs operating internationally, 'they are compliant with regulations in the countries where they operate and have bank accounts. In Somalia, it is difficult to tell because those regulations don't exist. There are attempts to oversee *hawala* by the new government but nothing's been achieved yet'. In 2016–17, with support from the World Bank, Abyrint AS, a management consultancy specialising in post-conflict states, was selected to assist the CBS with regulating and supervising money transfer businesses. A number of businesses have instituted compliance and KYC measures to reassure banks that they are transparent and that they recognise and are trying to avoid the threats of terrorism financing and money laundering.

3.2 Mobile money

Mobile money is extremely popular in Somalia: three-quarters of the population use it, compared to 15% who possess bank accounts (Firestone et al., 2017). Services are used for a variety of purposes, including 'cash-in transactions or deposits of eMoney to mobile money accounts, cash out transactions, and cash withdrawals. They are also used for bills, salary receipts and merchant payment transactions (of up to 5 times a month) typically ranging between $20–$200 each' (Firestone et al., 2017). Mobile services such as Hormud's EVC+ or Telesom's Zaad have been described as 'acting as a virtual, dollarized currency' in their own right. Like MTOs, mobile money is largely unregulated and lacks adequate oversight to ensure the transparency of transactions (Firestone et al., 2017). A new telecoms law passed in 2017 was meant to regulate the sector, but appears to have had little effect so far (Horn Observer, 2017). According to Firestone et al. (2017):

The current system in use in the majority of Somali territory lacks formal Know Your Customer requirements on customer identity and parity between eMoney and cash in banks. Many Somalis report that mobile money is unreliable and puts their money at risk because of a lack of interoperability between different services and transparency over funds. There are also reports of agents struggling to maintain cash for cash-out transactions while the system continues to lack customer guarantee.

3.3 'A few bad apples': Somali bankers' perspective on de-risking

While many Somali bankers interviewed for this study saw the merits of bank de-risking in so far as it seeks to combat financial crime, some viewed it as inherently 'malicious' and 'discriminatory' because 'policies are not well defined and it causes harm and destitution to many people, just because of a few bad apples'. Some also saw de-risking as an attack on Muslim nations; one banker described it as 'a financial embargo to weaken Muslim nations' and dismissed counter-terrorism as 'the brainchild of the West' and 'a pretext to wear off [weaken] Islamic financial systems'. Another described de-risking as Islamophobic.

Somali banks have encountered a number of challenges, and have witnessed the problems NGOs face as a result. One difficulty involves making transfers in US dollars when using correspondent banking overseas (this is less of a problem than when transferring euros or UK pounds through European banks). One banker described how they were advised to instead open bank accounts denominated in Dirham or other currencies, but subsequently clients' SWIFT codes were denied, affecting 1,000 businesses. A point made by one of the international NGOs interviewed for this study is that projects lose out as a result of losses in currency exchange: 'The USD rates are not open market rates and therefore lack transparency. The MTOs know that there is an opportunity to monopolise the situation and this adds costs to projects, which ultimately affects the beneficiary'.

Reputational damage is another risk. One representative of a bank that had accounts closed felt that the bank's reputation had been compromised, and it lost a large number of clients as transactions were blocked by the correspondent bank. Procedural difficulties can also make it more difficult for a bank to serve its clients:

> *Procedures for transferring money are extremely difficult. Imagine, a single transaction may take months before it reaches us, if it does. Most of the time we find out that some of the transactions are returned to the originating bank. Because of those delays, we have put a burden on our clients; actually, every single day we call them to provide answers to new questions provided by the corresponding bank.*

Lack of awareness among donors of counter-terrorism and anti-money laundering regulations within their country can also pose problems. 'Some donors have no clue about de-risking. They send money online, using SWIFT codes and IBAN, and then the process fails because they have not filled in all the necessary documentation required by the bank to make transfers to Somalia.'

4 De-risking and its implications for local humanitarian organisations

Respondents in the study generally highlighted the arbitrary nature of regulations and measures that lead to bank de-risking. One respondent, a senior staffer at an international humanitarian organisation, described an incident where a transaction to a beneficiary in Somalia was blocked because the recipient's name was found on a watch list. The individual was subsequently found to have died, and the transfer was eventually made. The majority of respondents for this study believed that many of the sources that form the foundation for online watch lists are unsound. One legal professional observed: 'They use wiki pages and other questionable sources to create those lists and once you are on a list, it is very difficult to get off of it'.

The study identified a number of serious implications of de-risking for humanitarian operations.

4.1 Operational difficulties and delayed transactions

At the focus group discussion in Mogadishu in 2017, local NGO representatives said that, while their bank accounts had not been closed, transactions were delayed or frozen without any clear explanation as to why. Some at the meeting stated that delays were a common occurrence; some faced transfer delays more than 20 times. For one organisation delays extended over three years.

It is difficult to judge if and when transfers through Western/international banks are going to be delayed en route to banks in Somalia. One respondent,[7] a humanitarian with operations in Somalia, described US banks as being difficult in allowing transfers to Somalia – 'banks generally don't give you reasons why transactions are delayed. We face more problems when it's an American bank that is making the transaction, it's easier through Europe'. According to the respondent: 'We are offered no explanation why the money is delayed. It is arbitrary and usually described as the bank's "internal process". There are contradictions and there is no rationale to it. If you are able to wait, you just wait, and eventually it will show up'. In order to cope with these delays, humanitarian organisations have called on Somalis in the diaspora to send funds through the *hawala* system, rather than through banks. Another alternative is to borrow money locally.[8] Respondents from international organisations also highlighted that they were facing 'operational difficulties' in making transfers to local organisations in Somalia, affecting their capacity to respond to problems quickly. As one respondent told us:[9]

> *When we release money to the national partner in Somalia, the process is complex and goes through several intermediary banks. The issue is that we are never really in control of the process. Once the money leaves our account, we give it one or two weeks and then realize that it got stuck. This is difficult to trace because we are not sure if it was blocked at the source bank or the intermediary bank.*

Delays have adversely affected the capacity of NGOs and local humanitarian actors, especially Islamic organisations, to respond. One respondent working for a local member of a regional Islamic organisation described how fund transfers between the two were 'questioned and sometimes blocked'. The implications were 'huge' because of 'the conflict and the natural

7 Author interview, 8 November 2017.

8 Author interview, 28 November 2017.

9 Author interview, 29 November 2017.

disasters. We are constantly in an emergency situation and life-saving is a top priority, we don't have the luxury to think about resilience and recovery! We must respond now!'.

4.2 Cash interventions at risk

While in remote areas cash may not be the best modality for humanitarian response because there are limited goods available to buy (CaLP, 2017: 7), cash transfer programmes are becoming increasingly popular in Somalia. OCHA is diversifying its cash programming, and cash programmes are being used as part of shelter, education and protection responses, as well as food. Some agencies are also shifting from conditional to unconditional cash to address different forms of vulnerability (CaLP, 2017).

Without MTOs, aid agencies would not be able to implement cash transfer programmes in the field. Mobile money operators are also becoming more important to the response. One Somali respondent who heads an international humanitarian organisation emphasised that the majority of their cash programming took place through hawala companies or MTOs with bank accounts in the US, Europe or the Gulf (mainly Dubai). As MTOs lose access to banking arrangements, the capacity to operationalise cash transfers locally will be at increasing risk.

4.3 De-risking is limiting local organisations' access to formal and transparent banking

Bank de-risking has added another layer of difficulty for local humanitarian organisations already facing serious challenges in accessing international humanitarian donors. Uncertainty about the legal consequences of any form of interaction with Al- Shabaab persists, even with regard to meeting humanitarian needs. US government agencies such as the Office of Foreign Assets Control (OFAC) have released statements designed to 'provide guidance to the public regarding making donations toward or undertaking the delivery of humanitarian assistance to Somalia', but these have failed to provide legal cover for organisations seeking to operate in Al-Shabaab-controlled areas. Many humanitarian organisations have strengthened compliance programmes or other internal mechanisms to help ensure that aid is not diverted (Modirzadeh, 2013).

A counter-terrorism regime that prioritises compliance over the humanitarian imperative has also affected local organisations' access to transparent, formal banking. 'Money Transfer Operators are de facto banks. You cannot transfer money internationally through the banking system so you have to work with MTOs', said one Somali humanitarian worker. Local humanitarian organisations cannot rely on banks for their transactions, and so resort to the private sector either through MTOs or through mobile banking: according to one respondent from an international humanitarian organisation operating in Somalia: 'More than 70% of the population uses mobile money which is completely unregulated. You have millions of dollars floating everywhere but it works, and is central to the humanitarian response'.

4.4 'A Western attack against Africans and Muslims'?

Some respondents from local NGOs viewed bank de-risking in terms of a Western attack or conspiracy against Muslims or Africans. When asked whether de-risking was justifiable, one respondent answered as follows:

> *I think the aim is to protect the interests of financial institutions and to prevent money laundering and terror financing. However, it is not justified because de-risking is a Western idea implemented by countries with stable financial institutions, hard currencies and political leverage. De-risking has nothing to do with African and Asian countries ravaged by civil wars, political crises and religious insurgencies. The implementation of such policies destroys humanitarian work and the lives of destitute people.*

Another respondent described de-risking as a means to 'keep Somalia desperate and at the mercy of the West and the US', and that it was an unjustifiable form of Western intervention in local Somali affairs – 'Every government has its own security apparatus and should know what organizations are doing inside and outside of their countries'.

Finally, one respondent described how de-risking was preventing Muslims from carrying out their religious duty to give money to charity:

> *The most painful statement I heard so far was when a desperate donor said: 'Our hands have forgotten what it's like to pay* sadaqqa *(alms).' Because of the restrictions created by de-risking, this donor has failed many times to send donations to the poor. He gave up and in his agony said those words. For a Muslim to give out* sadaqqa, *this is a personal duty and a religious obligation for those who have wealth. De-risking infringes the rights of the Muslim people to fulfil their religious obligations.*

5 Conclusion: de-risking creates risk

Local humanitarian organisations are being adversely affected by de-risking measures, which make it difficult to receive transactions through the formal banking system in a timely manner, and block MTOs as a viable channel for financial access and the transfer of remittances from the diaspora. For the local humanitarian sector to survive, systemic, structural shifts need to be put in place to ensure transparency within the financial system, and to open up channels for financial access for local humanitarian actors.

Interviews for this study with bankers, humanitarian personnel and academics point to the following:

- Money transfer companies, mobile money and other means of financial transactions outside the formal banking system are essential to the humanitarian response in Somalia.
- The popularity of MTOs may have contributed to the weakening of the CBS, which has had no oversight over money transfer businesses.
- Some local MTOs have questionable transparency measures and have contributed to aid diversion, but the majority of local and international MTOs have rigorous KYC measures in place.
- Some international organisations have stopped operating via MTOs in order to support more financial/aid transparency, but this means that many local humanitarian organisations are not able to use these funds because they do not have access to bank accounts.

This study calls for more long-term support from international humanitarian actors as well as financial regulators in the US and Europe for Somalia's financial and humanitarian sectors. It urges the various actors involved to manage risk, rather than trying to avoid it, by working with formal, less formal and informal financial actors in Somalia to ensure financial access for humanitarian actors and to create incentives for informal financial actors to submit to more regulation and join the formal financial sector.

5.1 Recommendations

The study's overarching recommendation is the urgent need to support Somalia's financial sector to facilitate much-needed humanitarian assistance and remittances, while also reducing financing for violent extremism. This will require investing in the country's financial infrastructure, as well as rethinking the utility of the counter-terrorism regime.

To the international community

Provide technical assistance to contribute to the development of Somalia's banking sector
Financial access for local humanitarian organisations will require a stronger banking sector. With support from the World Bank, the CBS and a number of money transfer companies are increasingly aligning their efforts to strengthen interbank payment, clearing and settlement systems in Somalia. The CBS is increasing its oversight of financial services in Somalia, though it is still weaker than the money transfer companies it is trying to regulate.[10] At the focus group discussion in Mogadishu in 2017, participants suggested a number of steps to limit bank de-risking, including establishing a thorough customer documentation system within Somali banks; encouraging the government to speed up the development of an ID system; enforcing a system of checks and balances within the financial sector; and enabling national banks and the CBS to play a more active role in clarifying counter-terrorism and anti-money laundering regulations with international regulators and financial institutions.

To donors and international humanitarian organisations

Amplify risk management
'It does not make sense that donors and humanitarians want to be able to fund a response in Somalia without

10 Author interview, 20 December 2017.

managing risk', emphasised one Somali humanitarian leader.[11] For donors, improved analysis of risk, including identifying triggers and push and pull factors, can contribute to better risk management. Strengthening the capacities of local partners in managing risk and the development of risk registers to monitor potential sources of risk can help prepare donors and the humanitarian sector for potential challenges in a humanitarian response. It also helps in managing donor expectations. In a context like Somalia, where corruption and aid diversion are well-documented, risk management should be at the core of the response.

For their part, banks should choose risk *management* over risk *avoidance*. Writing to the Chief Executive of Barclays in September 2013, Kevin Watkins, at the time the head of the Overseas Development Institute, identified two common challenges, and a possible solution:

> *I recognise that financing for an aid programme raises different fiduciary management issues than banking operations. Yet two common challenges stand out: tracking the money flow past the collecting agent through the clearinghouse, and conducting due diligence in verifying the identity of the receiver and ultimate beneficiaries. These challenges could be addressed through a dedicated Risk Management Unit to cover your Somali accounts. More generally, we would urge both Barclays and the UK government to develop constructive solutions to what are solvable problems* (Watkins, 2013).[12]

11 Author interview, 25 October 2017.

12 The letter was written ahead of a decision by Barclays on whether or not to close the accounts of money transfer companies in Somalia.

To bankers and regulators

Develop a more coherent global framework for counter-terrorism
A recurring theme in the interviews conducted for this study was the unpredictability and lack of consistency in the delays and blockages affecting transactions. Respondents highlighted that US banks are more restrictive than European ones, but it is often a mystery why some transactions are delayed and others are not. A more coherent global framework for counter-terrorism measures including bank de-risking is needed. One respondent said: 'It is important to discuss de-risking globally and countries should have a uniform framework in implementing global counter-terrorism measures, while ensuring that this does not harm people in a humanitarian crisis'.

To local Somali NGOs

Develop mechanisms to better manage counter-terrorism and anti-money laundering regulations. Somali bankers interviewed for this study called on Somali NGOs to ensure that they are registered and have adequate documentation of their financial transactions with donors to support transfers through banks made or received from overseas. Using auditors to increase the transparency of financial transactions was also suggested, alongside a risk register to enable organisations to build a comprehensive picture of the risks they are likely to face. Better planning and preparation can help unblock some of the delays in transactions.

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Humanitarian Policy Group
Overseas Development Institute
203 Blackfriars Road
London SE1 8NJ
United Kingdom

Tel. +44 (0) 20 7922 0300
Fax. +44 (0) 20 7922 0399
Email: hpgadmin@odi.org
Website: http://www.odi.org//hpg

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