

DOMESTIC REVIEWS OF THE NON-PROFIT (NPO) SECTOR: COMMON THEMES

Information paper by the FATF Secretariat

Issues to be considered by the WGTF:

Should the FATF issue additional guidance concerning Special Recommendation VIII (Non-profit organisations)?

- (a) If so, what form should that guidance take (i.e. an interpretative note, a second best practices paper, or some other form of guidance)?
- (b) If so, what should the substance of that guidance be?

Introduction

1. As part of its ongoing work on Special Recommendation VIII (SR VIII), the Working Group on Terrorist Financing (WGTF) invited delegations to conduct domestic reviews of their non-profit sectors (NPO sectors) and submit reports to the WGTF for review. The following 14 countries submitted reports: Australia, Austria, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, New Zealand, South Africa, Spain, United Kingdom and United States. The Secretariat has now prepared this information paper to suggest ways forward on this issue based on the common themes and conclusions that emerge from a review of these reports. The paper first re-states the problem of NPOs in the anti-money laundering (AML)/counter-terrorist financing (CFT) context and provides reasons for developing additional guidance. After proposing the form that the guidance should take, the paper indicates the basic concepts – identified as common themes in the 14 country NPO reviews – that should be incorporated into such guidance. The paper then concludes with a suggestion for developing specific guidance, and a draft proposal for the text of this guidance is then provided in an annex.

I. Statement of the problem – Is additional guidance on SR VIII needed?

2. The first question to be decided by the WGTF is whether additional guidance relating to SR VIII is needed. In developing measures to deal with terrorist financing, the Financial Action Task Force (FATF) recognised that certain attributes of non-profit organisations (NPOs) present particular vulnerabilities that may be exploited by terrorists for the purpose of raising and moving funds to finance their activities. To address this terrorist-financing risk, the FATF issued SR VIII in October 2001. The FATF became aware very quickly thereafter that the diversity of the NPO sector and the differences in the level of oversight among countries – as well as the lack of clear indications of concrete measures to be implemented within SR VIII itself – meant that additional guidance would be necessary to help countries deal with the issue. The FATF thus published a Best Practices Paper in October 2002 that offered a range of options for preventing misuse of NPOs for terrorist financing purposes. Since the publication of the best practices paper, FATF members – as demonstrated in the 14 recently-submitted NPO country reviews – continue to indicate their difficulties in implementing appropriate measures in this area. Anecdotal evidence from some non-FATF members also appears to show that the difficulties in finding solutions for this problem are not limited to FATF members. Consequently, it would seem that additional guidance on SR VIII is needed.

II. The form that additional guidance should take—An Interpretative Note

3. The FATF has already issued the following guidance that specifically relates to SR VIII: Guidance for Financial Institutions in Detecting Terrorist Financing (issued 24 April 2002) and the Best Practices Paper on SR VIII (BPP VIII) (issued 11 October 2002). However, as noted above, this guidance appears to be insufficient in providing countries with a framework for taking the necessary concrete steps to prevent or preclude misuse for terrorist financing purposes. Consequently, it would seem that there is a need for clearer indications for how AML/CFT measures should be applied in this

area, given the diversity, size and scope of the non-profit sector in different jurisdictions. Following the example given in the development of guidance for the other FATF Special Recommendations, an interpretative note to SR VIII would likely provide the clearest framework for AML/CFT guidance targeting the NPO sector. Additionally, an interpretative note reflecting essential criteria to prevent the potential exploitation of the non-profit sector by terrorists or terrorist organisations may help countries to implement SR VIII and facilitate the work of assessors when carrying out AML/CFT assessments.

III. The substance of the proposed Interpretative Note

A. Overall conclusions that can be drawn from the NPO sector domestic review reports

4. Before discussing the elements of any new AML/CFT guidance for the NPO sector, it would be useful to examine the overall conclusions that can be drawn from the experience of the 14 countries that submitted reports concerning their domestic non-profit sectors. The following points should therefore be considered:

- (a) ***The NPO sector is diverse:*** Most (if not all) domestic NPO sectors have extremely diverse characteristics.
- (b) ***Certain NPO activities represent a high terrorist-financing risk:*** Certain aspects of the NPO sector are more vulnerable to terrorist financing than others. For instance, in some countries there is a high risk of terrorist financing through NPOs which engage in public fundraising where the funds are intended for beneficiaries abroad, particularly where those beneficiaries are located in high risk jurisdictions.
- (c) ***AML/CFT measures should be strengthened without unduly impeding the work of NPOs:*** The NPO sector is a vital and integral component of the economies of almost all countries and makes a valuable contribution to the community and supplies a broad spectrum of public services relating to a variety of objectives including: alleviating financial hardship; advancing religious or political beliefs; providing education; offering health, employment, housing, self-help or social services; promoting research; facilitating sports, leisure or hobby activities; advancing environmental, cultural or civic causes; delivering international aid; or delivering charity to the local or some other community. AML/CFT measures should be strengthened in a way that does not unduly impede this work, but rather protects the integrity of the sector itself, and its supporters.
- (d) ***Although the detection of terrorist financing is impeded by the fragmented quality of supervision/monitoring in the NPO sector, in most countries, some direct and indirect supervision of the NPO sector already exists:*** The detection of terrorist financing in the NPO sector is hampered by a number of factors including the size and diversity of the sector itself, gaps in the monitoring or oversight regime, and the general scope of current measures. For instance, few countries have a designated competent authority that is responsible for monitoring/supervising NPOs. Nevertheless, in most countries, at least part of the NPO sector is supervised directly by the tax authorities (i.e. when an NPO must register with the tax authorities in order to obtain favourable tax treatment such as a tax exemption). Additionally, NPOs are monitored indirectly when they perform financial transactions through financial institutions that are subject to AML/CFT obligations, particularly those relating to customer due diligence and reporting of suspicious transactions.
- (e) ***Governments should engage in a comprehensive and sustained outreach campaign with the NPO sector.*** All countries presenting domestic reviews of their NPO sectors recognized common fundamental problems associated with limited government resources and expertise regarding the NPO sector on the one hand, and the terrorist financing

vulnerabilities, size, diversity, importance and traditional independence of the NPO sector on the other hand. These common limitations and characteristics will require governments to engage in outreach campaigns with the NPO sector to effectively address the threat of terrorist abuse. Governments should foster a co-operative relationship with the sector that recognizes not only the vital role of the sector in the international economy, but also the critical importance of maintaining public confidence in the integrity of the sector. Given the past abuses and ongoing risks of abuse of the sector by terrorists, governments must work with the charitable community to address vulnerabilities that terrorists may continue exploiting and which threaten the integrity of the sector.

B. Proposals for addressing issues that relate to those overall conclusions

5. The issues relating to the overall conclusions (set out above) should be addressed in the substance of an interpretative note to SR VIII (INSR VIII). The following suggestions would address those issues and could be incorporated into such a text.

6. ***Address the NPO sector's diversity by adopting a functional definition of NPO:*** The WGTF should consider adopting a functional definition of *non-profit organisation* (i.e. a definition based on the activities conducted by the NPO), rather than a legalistic definition (i.e. based on characteristics of the NPO such as size, income or organisational structure). Each of the 14 countries reported a very large NPO sector that lacks uniformity—even at the domestic level. NPOs vary in size and income level (small, mid-size, large), organisational structure (i.e. associations, foundations, co-operatives, societies, religious entities, political parties, trade unions or private limited companies), legal status (i.e. incorporated or unincorporated), and membership and scope (i.e. local, regional, national or international). Given this diversity, it is not possible to develop a uniform definition of *non-profit organisation* based on the physical characteristics of the sector. Adopting a functional (rather than a legalistic) definition of *non-profit organisation* is also consistent with the approach taken in BPP SR VIII (see paragraphs 1-3).

7. ***Address risk in the NPO sector by restricting the definition to those NPO that represent a high terrorist financing risk:*** In adopting a functional definition of *non-profit organisation*, the WGTF should consider restricting the application of CFT measures to those NPOs that represent a high terrorist-financing risk. However, in light of the sector's overall diversity, certain characteristics that may be high-risk in one country may not be high-risk in another. Consequently, the application of CFT measures to *NPOs under SR VIII* should be flexible enough to allow each country to identify, on the basis of a risk-based approach, the NPOs in its domestic sector that represent a high terrorist financing risk.

8. ***Address concerns about unduly impeding the work of NPOs by strengthening AML/CFT measures applicable to NPOs that carry out high risk activities:*** Adopting a functional and restrictive definition of *non-profit organisation* would facilitate the strengthening of AML/CFT measures in relation to NPOs that represent a high terrorist-financing risk (as set out above). This approach would ensure that the NPO sector is not unduly burdened with regard to NPOs that do not carry out high risk activities. Moreover, this approach allows for the effective targeting of scarce AML/CFT resources. The WGTF should encourage countries to continually assess AML/CFT risks associated with the NPO sector to ensure that responsive measures address potentially new vulnerabilities and changing terrorist tactics.

9. ***Take full advantage of existing mechanisms for directly or indirectly monitoring/supervising NPOs:*** The 14 reports have identified mechanisms that already exist for directly or indirectly monitoring/supervising NPOs. Whenever possible, AML/CFT measures should be strengthened by using pre-existing mechanisms more effectively. Existing mechanisms which are important sources of relevant information on NPOs are: (i) tax authorities (particularly when an NPO is applying for favourable tax treatment); (ii) other competent authorities responsible for registering NPOs (where

applicable); and (iii) financial institutions (particularly when performing financial operations/transactions for NPOs).

10. Engage in a comprehensive and sustained outreach campaign to enlist the support, resources, experience and expertise of the sector in combating terrorist abuse. Governments should develop and sustain comprehensive outreach programs to: (i) raise awareness of terrorist financing risks; (ii) develop guidance and policies to protect against such risks, and (iii) encourage the development of self-regulatory, academic research and information-sharing bodies to inform policymakers as well as donor and charitable communities on terrorist financing-related matters.

IV. Conclusion

10. The WGTF should make the following recommendations to the Plenary:

- (a) Additional guidance on SR VIII should be issued;
- (b) That guidance should be in the form of an Interpretative Note; and
- (c) The substance of the Interpretative Note should contain:
 - (i) A functional definition of *non-profit organisation* that focuses on characteristics that may make an NPO a high terrorist-financing risk; and
 - (ii) Strengthened AML/CFT measures that make use of existing mechanisms whenever possible and minimise the negative effects of fragmented monitoring/supervision of the NPO sector.

11. The following annex contains a draft text of INSR VIII.

FATF Secretariat
11 March 2005

D R A F T**INTERPRETATIVE NOTE¹
TO SPECIAL RECOMMENDATION VIII (NON-PROFIT ORGANISATIONS)****Objectives**

1. The ongoing international campaign against terrorist financing has demonstrated that the non-profit sector has been abused by terrorist organizations and continues to be vulnerable to such abuse for a variety of reasons. Non profit organizations (NPOs) enjoy the public trust, have access to considerable sources of funds, and are often cash-intensive. Furthermore, some NPOs have a global presence that provides a framework for national and international operations and financial transactions, often within or near those areas that are most exposed to terrorist activity. Finally, depending on the country and legal form of the NPO, they are often subject to little or no regulation (for example, registration, record keeping, reporting and monitoring) or have few obstacles to their creation (for example, there may be no skills or starting capital required, no background checks necessary for employees, etc.) Terrorist organizations have taken advantage of these vulnerabilities to infiltrate the NPO sector and abuse NPO funds and operations to support terrorist activity..

2. Special Recommendation VIII (SR VIII) was developed with the objective of ensuring that non-profit organisations are not misused: (i) by terrorist organisations posing as legitimate entities; (ii) to exploit legitimate entities as conduits for terrorist financing or escaping asset freezing measures; and (iii) to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations. This Interpretative Note underscores the need to collect information on non-profit organisations that may be particularly vulnerable to terrorist-financing risks and to make that information immediately available to the competent authorities in appropriate circumstances. It is not the intention of the FATF to impose rigid standards that will unduly impede the legitimate and necessary work and services provided by the non-profit sector, but rather, to encourage oversight and safeguards that maintain the integrity of the sector by protecting it from terrorist abuse.

Definitions

3. For the purposes of SR VIII, and this interpretative note, the following definitions apply:

4. The terms *FIU*, *legal arrangement* and *legal person* are as defined by the FATF Forty Recommendations (2003) (the FATF Recommendations).

5. The term *funds* is as defined by the Interpretative Note to FATF Special Recommendation II.

6. The terms *freezing*, *terrorist* and *terrorist organisation* are as defined by the Interpretative Note to FATF Special Recommendation III.

7. A *non-profit organisation* or *NPO* refers to an organisation, legal person, legal arrangement or other type of body that: (a) conducts charitable activities as a primary or substantial part of its business, including as an ancillary part of a separate business enterprise; and (b) has been identified as being at a high risk of being misused for the financing of terrorism, pursuant to an assessment carried out in accordance with paragraph 8 below.

¹ [NOTE TO THE WGTF: New Zealand takes the position that further guidance on SR VIII should be in the form of a revised Best Practices Paper (not an Interpretative Note).]

Obligation to identify NPOs

8. Countries should conduct an assessment of their domestic non-profit sector, using all the sources of information available², in order to identify which organisations, legal persons, legal arrangements or other types of bodies are, by virtue of their characteristics or activities, at a high risk of being misused for the financing of terrorism. Countries should periodically reassess this risk to consider new information about terrorist activities and potentially new vulnerabilities of the non-profit sector. When conducting such assessments, countries should, at a minimum, consider the terrorist financing risks, typologies and policy considerations potentially applicable to the non-profit sector as described in: (i) the FATF Guidance for Financial Institutions in Detecting Terrorist Financing; (ii) the FATF Report on Money Laundering and Terrorist Financing Typologies 2003-2004, and (iii) the FATF's International Best Practices Paper for SR VIII.

Licensing or registration and compliance

8. Countries should ensure that non-profit organisations are licensed or registered with a designated competent authority. Countries need not impose a separate licensing/registration system or designate another competent authority in respect to NPOs that are already licensed or registered within a particular country and subject to some monitoring or supervision.³

9. Countries should ensure that the competent authority's monitoring or supervision of NPOs includes:

- a. Confirmation that the NPO is keeping records as required pursuant to paragraphs 12 and 13 below;
- b. Verification that the NPO's funds are accounted for and that funds have been spent as advertised and planned, in a manner that is consistent with the stated purpose and objectives of the NPO's charitable activities; and
- c. Consideration of whether there is suspicion or reasonable grounds to suspect that the NPO: (i) is a charitable front for a terrorist organisation; (ii) is being exploited as a conduit for terrorist financing, including for the purpose of escaping asset freezing measures; or (iii) is concealing or obscuring the clandestine diversion of funds intended for legitimate purposes but redirected for the benefit of terrorists or terrorist organisations. If such suspicions or reasonable grounds exist, the competent authority should be required, directly by law or regulation, to report promptly its suspicions to the financial intelligence unit (FIU) or an empowered investigative authority.

11. Countries should ensure that competent authorities of different regional or local Administrations coordinate their criteria for registering or licensing, be it through legislative measures or otherwise, and are able to share information among themselves and with law enforcement or FIUs.

Record-keeping and disclosure obligations

12. NPOs should maintain and make publicly available, for the duration of their existence, records that set out: (i) the purpose and objectives of their charitable activities; (ii) the identity of the person(s) who own, control or direct their activities, including board and executive members and

² For example, charity regulators, tax authorities, FIUs, donor organisations or law enforcement and intelligence authorities.

³ For example, in some countries, NPOs may already be registered with the tax authorities and monitored or supervised in the context of qualifying for favourable tax treatment (such as a tax credit or tax exemption).

directors; and (iii) a programme budget that accounts for all programme expenses, including the identity of recipients and how the funds are to be used.

13. NPOs should maintain and make available to competent supervisory or investigative authorities upon request, for at least five years, all necessary records on transactions, both domestic and international, to enable them to comply swiftly with information reconstruction of individual transactions (including the amounts and types of currency involved) so as to provide, if necessary, verification that funds have been spent as advertised and planned.

Enforcement mechanisms for NPOs that do not comply with applicable rules and regulations

14. Countries should adopt appropriate measures to monitor effectively the compliance of non-profit organisations with applicable rules and regulations. Persons acting on behalf of NPOs who fail to comply with such rules and regulations should be subject to civil, administrative or criminal sanctions. This should not preclude parallel criminal, civil or administrative proceedings with respect to NPOs in countries in which such forms of liability are available.

Outreach to private sector

14. Countries should undertake awareness and outreach programmes to educate the NPO sector and the financial community about the vulnerabilities of NPOs to terrorist abuse, and terrorist financing risks and indicators associated with the NPO sector. Countries should develop a cooperative relationship with the non-profit sector that underscores the need to address terrorist financing risks in order to preserve and promote public confidence in the integrity of the sector.

15. Countries should work with the NPO sector to develop and refine regulations and best practices to address terrorist financing risks and vulnerabilities and to protect the sector from terrorist abuse. Countries should also provide guidance for financial institutions dealing with the NPO sector, especially in area of detecting suspicious transactions.

16. Countries should encourage the development of self-regulatory organizations, academic research and information sharing bodies within the NPO sector to address terrorist financing-related issues.