



## Case Study: U.S. Nonprofit Organizations and the FATF Mutual Evaluation Process 2015-16 November 2017

This case study summarizes the experience of the Charity & Security Network (C&SN), a diverse network of nonprofit organizations (NPOs) in the United States that sought to provide input on U.S. anti-terrorist financing laws to the Financial Action Task Force (FATF) during its mutual evaluation of the U.S. The evaluation took place between early 2015 and December 2016, spanning a period of significant changes in FATF’s recommendation and guidance relative to NPOs. After describing C&SN’s efforts and assessing the experience, this paper makes several recommendations for FATF and NPOs to consider for future evaluations.

### Context and Background

The FATF is a task force of 37 member states that sets standards for anti-money laundering and counterterrorist financing (AML/CFT) laws that are used globally. It conducts periodic evaluations of compliance with these standards in over 180 countries. Its Recommendation 8 (R8) on NPOs was revised in June 2016, capping four years of successful engagement between FATF and the Global NPO Coalition on FATF. The revised R8 recognizes that not all NPOs are at risk of terrorist financing abuse and directs countries to undertake a proportionate, risk-based approach when considering counterterrorism financing measures. The evaluation of the U.S. was conducted under the old version of R8, which characterized NPOs generally as being “particularly vulnerable” to terrorist abuse.<sup>1</sup> This had contributed to overregulation and inappropriate restrictions on NPOs in many countries, hampering legitimate and essential work around the world.<sup>2</sup>

It is important to note that during the time the U.S. evaluation was underway FATF’s evaluation process underwent a transition from a “check-the-box” technical compliance approach to a risk-based approach that emphasizes effectiveness.<sup>3</sup>

Although currently there are no formal entry points for NPOs to engage in FATF’s evaluation process, the ongoing constructive engagement between FATF and NPOs globally during this period has opened



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<sup>1</sup> Only evaluations that began after June 2016 are conducted under the revised R8.

<sup>2</sup> Ben Hayes, “Counter-terrorism “policy laundering” and the FATF: Legalising Surveillance, Regulating Civil Society”, Transnational Institute/Statewatch March 2012 Online at <http://www.statewatch.org/analyses/no-171-fafp-report.pdf>

<sup>3</sup> In June 2015 FATF updated its guidance *Best Practices: Combatting the Abuse of Nonprofit Organizations*,<sup>3</sup> which set out examples of good practices to assist countries’ implementation of R8, in line with Recommendation 1 (the risk-based approach), and consistent with “countries’ obligations to respect freedom of association, assembly, expression, religion or belief, and international humanitarian law.”

new channels of communication.<sup>4</sup> It generated interest at C&SN in providing evaluators with information and insights based on U.S. NPOs' experience in the post-9/11 era.

### Points of NPO Engagement with FATF on the U.S. Evaluation, Materials Submitted

In early January 2015, C&SN inquired about possibilities of providing input into the evaluation process. It learned from the FATF that:

- It is best to send information at least six months prior to the evaluation team's on-site visit (estimated date provided on the FATF website<sup>5</sup> as January/February 2016) in order to be available to evaluators in drafting the "scoping paper," a document that outlines the primary issues and areas of inquiry for the evaluation.
- Documents should be short and simple.

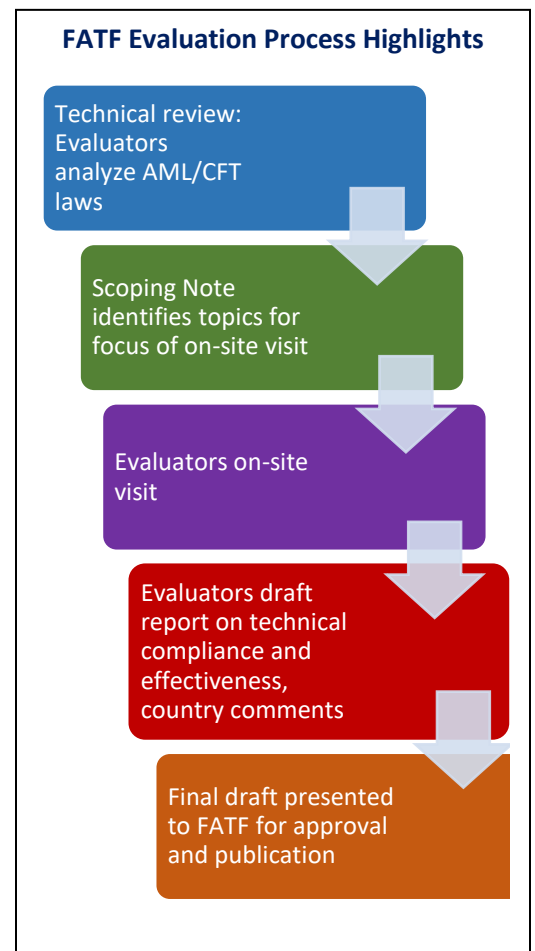
C&SN and the Council on Foundations (COF) worked together to collect input from their members and draft a written submission to FATF. Since no format for submitting comments was available, the criteria set out in FATF's 2015 revised Best Practices Paper on R8 was used to draft a memo,<sup>6</sup> submitted to FATF in July 2015.

These criteria were whether U.S. law:

- Is risk-based
- Has proportional restrictions
- Uses proportional sanctions
- Protects and not disrupts the activities of legitimate NPOs
- Is flexible
- Is consistent with international humanitarian law.<sup>7</sup>

Without a template or form to use, C&SN and COF were unsure how much background information evaluators would have. As a result, the 27-page memo erred on the side of inclusiveness, describing each relevant law, how it applies to NPOs (with examples) and explaining how each measures up to the criteria in the Best Practices Paper.

In September 2015 C&SN received negative feedback from FATF staff on the July memorandum, who said it was too lengthy and should have followed Immediate Outcome 10 (IO 10) of FATF's



<sup>4</sup> See [http://ecnl.org/wp-content/uploads/2016/12/FATF\\_Evaluations\\_Meeting\\_2016\\_Outcomes.pdf](http://ecnl.org/wp-content/uploads/2016/12/FATF_Evaluations_Meeting_2016_Outcomes.pdf)

<sup>5</sup> <http://www.fatf-gafi.org/media/fatf/documents/assessments/Global-assessment-calendar.pdf>

<sup>6</sup> The memo, available online at

<http://www.charityandsecurity.org/sites/default/files/files/FATFUSEvalMemo2015.pdf>, used input from a June 2016 survey of C&SN members

<sup>7</sup> Overall, the memo found "U.S. counterterrorism laws, as applied to nonprofit organizations (NPOs), fall short of these standards due to over-regulation. This in turn impedes the laws' effectiveness in achieving FATF's desired outcomes."

evaluation methodology.<sup>8</sup> (IO 10 includes factors for evaluating implementation of Recommendations 1, 4, 6 and 8) This was the first time C&SN and COF heard that the IO 10 format should have been used. C&SN considered producing a shorter memorandum following IO 10 criteria, but found IO 10 was not easily adapted into a framework for comments. As the time for influencing the scoping paper had passed, C&SN and COF determined that it was too late to redo their submission. Instead, the focus shifted to providing two new documents for the evaluation team: an analysis of the June 2015 National Terrorist Financing Risk Assessment published by the U.S. Department of Treasury and a 7-page list of relevant studies, Congressional testimony and letters, including links and abstracts. These were submitted in November 2015.

### **The On-Site Visit:**

Throughout 2015 Treasury officials provided NPOs with brief updates on the evaluation process during its quarterly informational meetings. Having heard from NPOs in some other countries that evaluation teams met with representatives of diverse nonprofit groups during site visits, C&SN and COF anticipated a similar approach in the U.S. As membership organizations, COF and C&SN were in a position to help evaluators reach a diverse group of NPO stakeholders. In July and November 2015 they offered to assist FATF's evaluation team with contacting NPOs for such a meeting. There was no response to these offers.

At a January 2016 meeting Treasury said that in February the on-site team would meet with three service organizations, but declined to identify the groups. It was unable to say whether or not grantmakers (private foundations) were considered to be "service organizations." COF and other associations representing NPOs doing international work were not contacted.

The lack of transparency about the on-site visit created concern among NPOs that insufficient attention would be paid to the issue of over-regulation. As a result, COF and C&SN wrote to the FATF Secretariat on Feb. 12, 2016 raising concerns about the on-site visit and the need for evaluators to speak with diverse representatives of the sector. FATF responded that the evaluation process must be the same for all countries and that to publicly identify NPOs that meet with evaluators could, in some cases, lead to retaliation. It also stressed that the evaluators must be independent and without pressure on whom they should meet or what input is incorporated into their report. COF and C&SN responded, acknowledging that these are valid concerns, given the different country contexts FATF operates in, but that in the U.S. context, uncertainty about how outside stakeholders can have input raised concerns about independence among NPOs.

### **Evaluation Published: Mixed Results from NPO Viewpoint**

FATF's Mutual Evaluation of the United States<sup>9</sup> was published on Dec. 1, 2016, with mixed results from the NPO perspective.<sup>10</sup> Overall, the evaluation noted that terrorist financing laws set a "strict liability" standard, but that application of the law to NPOs has been risk-based and proportionate. C&SN's analysis noted that, "FATF's recognition that the U.S. anti-terrorist financing rules are "strict liability" is

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<sup>8</sup> See p. 117-119 of FATF's METHODOLOGY FOR ASSESSING TECHNICAL COMPLIANCE WITH THE FATF RECOMMENDATIONS AND THE EFFECTIVENESS OF AML/CFT SYSTEMS, Updated November 2017 Online at <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF%20Methodology%2022%20Feb%202013.pdf>

<sup>9</sup> <http://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-united-states-2016.html>

<sup>10</sup> Charity & Security Network, *FATF's 2016 Evaluation of the U.S. -Summary and Analysis* online at <http://www.charityandsecurity.org/node/1480>

helpful, but there is no discussion of how such “zero tolerance” rules measure up to a risk-based approach. This may reflect the fact that the evaluation was conducted under the old R8,,,,.”<sup>11</sup>

FATF scored the U.S. as “largely compliant” with the old R8. Its analysis included several findings that were helpful but also some NPOs disagreed with. In particular, FATF found that:

- The main terrorist financing threats do not include the nonprofit sector. Instead it notes that threats include “raising funds through criminal activity, individuals raising funds under the auspices of charitable giving but outside of any charitable organization...” [p. 5 paragraph 4]

This finding acknowledges the research and evidence that has emerged in the past decade, dispelling the post 9/11 notion that NPOs are a significant source of terrorist funding. It also demonstrates the positive effects of efforts by both NPOs and government to protect the sector from terrorist abuse. With this analytical starting point, NPOs hope the U.S. will move toward a more proportionate, risk-based approach to counterterrorism rules impacting NPOs.

- Paragraph 234 stated that “Measures applied to NPOs are risk-based, and focused on targeted outreach and engagement with NPOs most at risk for abuse by terrorists.”

C&SN and COF disagreed with these findings.<sup>12</sup> U.S. NPOs have long argued that 1) counterterrorism measures unduly restrict their activities<sup>13</sup> and 2) outreach to NPOs is inadequate to meet the requirements of R8. The comments submitted by C&SN and COF made these points clear, but they were not addressed or acknowledged in the report. Instead the evaluation erroneously equates risk-based enforcement policy under the Obama administration with the letter of the law itself. In addition, the evaluation did not address the U.S.’s failure to conduct required outreach to the NPO sector in assessing risk to NPOs.<sup>14</sup> NPOs have pushed to expand the scope of the “outreach” meetings with Treasury, which are primarily limited to information exchange as opposed to dialogue aimed at addressing issues.

- Paragraph 234 goes on to note that, “Striking the right balance and avoiding the disruption of legitimate NPO activities can be challenging, particularly in higher-risk conflict zones. As violations of TF- related TFS [terrorist financing sanctions] are strict liability offenses, the authorities should continue to work with the NPO community to understand and mitigate the real TF risks that exist, while engaging stakeholders on banking challenges that some NPOs may face when working in conflict zones. The U.S. authorities are aware of the continuing challenges in this difficult area and are encouraged to continue their efforts, including work with the private sector.”

This finding identifies a fundamental contradiction at the heart of the U.S. anti-terrorist financing regime: it is strict liability in a risk-based environment. By identifying the challenge this presents for

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<sup>11</sup> <http://www.charityandsecurity.org/node/1480>

<sup>12</sup> *Id* at 9 “As FATF notes, the U.S. has not undergone this [review of laws and measures] process since 2003. Things have changed substantially since then. Although U.S. authorities claim to have “ongoing review” of these laws, it has failed to address concerns NPOs have raised about the disruptive effect of U.S. laws and measures on legitimate NPOs.”

<sup>13</sup> *Id* at 6

<sup>14</sup> The U.S. based its risk assessment on government documents and did not conduct outreach to the nonprofit sector on the nature of risks it faces. See analysis at [http://www.charityandsecurity.org/analysis/US\\_Natl\\_TF\\_Risk\\_Assmt\\_2015](http://www.charityandsecurity.org/analysis/US_Natl_TF_Risk_Assmt_2015)

legitimate NPOs and encouraging the U.S. to work to resolve them, FATF sets a clear, positive direction for both NPOs and government to move forward.

This process has begun. Since publication of the evaluation, the U.S. has actively engaged in a multi-stakeholder dialogue sponsored by the World Bank and Association of Certified Anti-Money Laundering Specialists (ACAMS) to address the financial access problems NPOs are experiencing.<sup>15</sup> For example, it is now considering proposed revisions to the nonprofit section of the Bank Examination Manual, which guides federal bank regulators when auditing banks. By replacing outdated language reflecting the old R8 view of NPOs as all high-risk customers and providing guidance on the risk-based approach, the revisions could help address the serious problem of financial access for NPOs.<sup>16</sup>

## Observations

The timing of the U.S. evaluation, carried out under the old R8 and early in emerging engagement between NPOs and FATF about the evaluation process, affected the way NPOs approached it. There was high interest among C&SN and COF members, who hoped the evaluation process would exert influence on the U.S. to move further away from strict liability legal standards. Even though, as FATF noted, enforcement policy has taken a risk-based approach, the potential for severe penalties under the strict liability in the law has a continuing chilling effect on many NPOs, particularly those working in conflict zones. As a result, NPOs worked hard to ensure that their perspective was taken into account.

However, the lack of a formal process for stakeholder input led to confusion about what should be submitted and when, what form input should take and how the on-site visit would work. The result was frustration among NPOs and concerns about the evaluation team's independence from U.S. government influence. At the same time, FATF seemed to perceive NPOs' desire to engage during the on-site visit as potentially undermining that independence.

NPOs' experience with the process taught valuable lessons. Providing too much information in written comments was a mistake. NPO submissions need to be brief so that evaluators, who have reams of documents to review, can get the best information in the limited time they have. However, Immediate Outcome 10 does not easily translate into a template for NPO input. It is organized as a tool for evaluators and the format reflects this. The concepts in it however, could form the basis of a template for input. A proposed template is attached.

### **“Enhancing Effective Implementation of FATF Standards on Nonprofits” 2016 London Workshop**

In September 2016, the Global NPO Coalition on FATF hosted a meeting with NPOs, FATF staff and government representatives in London. This highly productive discussion produced key recommendations to improve the risk assessment and evaluation processes for governments and NPOs alike, drawing on lessons learned under the new evaluation methodology and taking revision of R8 into account.

Recommendations include creation of guidance for all parties and training for evaluators on NPO issues and the revised R8.

A report on the meeting is online at [http://fatfplatform.org/wp-content/uploads/2016/10/FATF\\_Evaluations\\_Meeting\\_2016\\_Outcomes.pdf](http://fatfplatform.org/wp-content/uploads/2016/10/FATF_Evaluations_Meeting_2016_Outcomes.pdf)

<sup>15</sup> Charity & Security Network, Financial Access for U.S. Nonprofit Organizations, Feb. 7, 2017 online at <http://www.charityandsecurity.org/FinAccessReport>

<sup>16</sup> For data on the problem see Sue Eckert, Kay Guinane and Andrea Hall, *Financial Access for U.S. NPOs*, Charity & Security Network February 2017 Online at <https://www.charityandsecurity.org/FinAccessReport>

## Recommendations – Based on Experience of U.S. NPOs

Going forward, FATF and NPOs should identify ways in which stakeholders can better understand the process and establish a common format and process for stakeholders to provide input. In June 2017 FATF published procedures for the current round of evaluations that provide clear information on the steps to be taken and timelines used.<sup>17</sup> This helpful document can be used to establish clear guidelines for stakeholder input into evaluations.

Based on the experiences described above, we recommend:

For FATF:

- Develop and publish guidance for stakeholders on when and how to provide input into the evaluation process, including creation of an optional template based on Immediate Outcome 10.
- Set a date for receipt of written input that allows evaluators to consider it when drafting the Scoping Paper.
- Set up a web-based process or a regular email address for FATF and FATF-style regional bodies that NPOs can use to submit comments during the evaluation process, as was successfully done in FATF's open public comment process for revision of R8.
- Be aware and address the problem of over-regulation in the effectiveness component of the evaluation, as it often impedes the implementation of the FATF standards and negatively influences country rating on R8.
- Facilitate communication between evaluators and NPOs during the on-site visit. To the extent possible, create consistent practices between countries on such contacts. Recognize diversity within the NPO sector in different country contexts.
- Work with evaluators to achieve consistency in how countries are rated on R8 implementation, including review of whether or not a country conducts outreach on the risk assessment and outreach and engagement during the evaluation process.

For NPOs:

- Because the evaluation focuses on the risk assessment, where possible, NPOs should respond to and participate in the country's outreach for its required risk assessment of the NPO sector, which typically occurs prior to the evaluation process.
- If risk assessment findings on the NPO sector are not published, NPOs should push governments to make them public (findings, not necessarily the entire documents).
- If there is substantive disagreement with the country's risk assessment findings, produce a shadow report and share with FATF.
- If there is no outreach to NPOs during the risk assessment process, notify FATF and evaluators.
- When drafting written comments, assume evaluators already have adequate background information on the country's anti-terrorist financing laws, regulation of NPOs and basic information on the NPO sector.
- Keep written input short and simple, following the criteria in IO 10 (see suggested template, attached).

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<sup>17</sup> "Procedures for the FATF Fourth Round of AML/CFRT Mutual Evaluations" Updated June 2017 Online at <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF-4th-Round-Procedures.pdf>

- Ensure that associations representing NPOs are in contact with FATF and available to help prepare for and facilitate meetings with evaluators. Coordinate before meeting with evaluators.
- Copy the country's FATF point of contact on all input (unless it is not safe to do so). Be aware that all inputs sent to the FATF and evaluators will be shared with the government.
- Assemble lists of relevant research, reports, public documents, testimony, etc. to provide to FATF, with short descriptions and links for each. Give priority to publications from official bodies, such as the UN, other international and regional inter-governmental organizations, and academic research.

## **Conclusion**

NPOs fully support and respect the independence of FATF evaluation teams. But the opacity of the process, which protects the independence of the evaluation team on the one hand, made it difficult for U.S. NPOs to identify the right points of input on the other. Greater transparency about how evaluations are conducted and clear points of entry for stakeholder input would bolster credibility in the process and ensure more effective implementation of FATF standards in the long run.



## Sample Template for NPO Input Based on Immediate Outcome 10

NPO Name \_\_\_\_\_ NPO website: \_\_\_\_\_

Contact person \_\_\_\_\_ Contact Email: \_\_\_\_\_

Brief description of NPO: (i.e. service organization, umbrella organization, academic institution, think tank, human rights defender, etc.)

Brief description of NPO's expertise supporting its comments:

\_\_\_\_\_

**Risk assessment of NPOs:** Has the country conducted outreach to NPOs as part of its risk assessment of the sector? Is the risk assessment findings available to NPOs? If so, does it appropriately reflect the various levels of risk within the NPO sector? If not, explain why not and what should be changed.

If the findings of risk assessment are not available, clearly state that and actions you took to obtain them. Consider providing input on your own (shadow) risk assessment and existing measures NPOs undertake to mitigate those (these include self-regulation and internal mechanisms, not only regulations).

**Focused, proportionate measures that do not disrupt or discourage legitimate NPO activities:** Do the legal obligations and restrictions that affect NPOs disrupt or discourage legitimate NPO activities? If so, how? Give examples. How could risks be managed or mitigated in a way that is more proportionate and targeted to risk? Give example which measures could be less disruptive for NPOs than the current ones.

**Sustained outreach:** Does the country conduct regular outreach to and engagement with NPOs on the topic of countering terrorism financing, and if so, is this a dialogue that goes beyond information sharing?

**Targeted supervision and monitoring:** Is supervision and monitoring of NPOs by the regulatory bodies targeted to risks that are identified in the risk assessment? If not explain what are the problems/issues (i.e. burdensome regulation applies to all NPOs regardless of risk level, etc.).

**Effective investigation and information gathering:** Is the level of NPO reporting obligations logically connected to risks of terrorist abuse and is it proportionate to that risk? Do government investigations appear to be targeted by risk factors or other reasons? Does the government have adequate resources and capacity for monitoring all regulatory requirements? Are there discrepancies between procedures of different governmental bodies tasked with investigation?

**Effective mechanisms for international cooperation:** Has the NPO seen evidence of this? If so, has the impact on NPOs been proportionate and non-disruptive? If not, explain why.