

Nonprofit Organizations and the Combatting of Terrorism Financing

A Proportionate Response

Emile van der Does de Willebois



THE WORLD BANK

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Executive Summary

One of the ways that terrorist organizations raise and transfer funds is by using the fundraising power, and the aura of charitable activity, of nonprofit organizations (NPOs). Ever since the adoption of the Special Recommendation VIII on the abuse of NPOs Terrorism Financing purposes by the FATF in October 2001, countries have struggled to find a proper way to address the potential terrorism financing risk posed by NPOs. The issue at stake is to strike a balance between addressing a potential threat and ensuring NPOs have the freedom to operate. In many important ways, the work of NPOs deal with the conditions conducive to the spread of terrorism; therefore, it is essential that in trying to address one aspect of the terrorist threat—terrorism financing—we do not inadvertently diminish the impact of other ways of tackling the issue.

This article argues that, when discussing the threat and how to address it, policy-makers need to be specific and not paint the whole sector with the same brush. Virtually all governments already interact with the NPO sector in one way or another. These preexisting avenues should be used for dealing with this issue; it is inefficient and ultimately counterproductive to devise an entirely new regulatory framework. The ultimate objective is to enhance the transparency of the sector—to ensure information is available on the people in charge of NPOs, their sources of funds, and, particularly, the way those funds are spent. This aim serves a much wider purpose than just terrorism financing and touches on many aspects of good governance of civil society that the sector itself and others have been debating for a long time. When devising public policy on how to deal with possible terrorism financing through the nonprofit sector, the contribution of the NPO sector to fighting terrorism should be recognized and used to its full advantage. Moreover, the NPO sector's own stake in being "clean," and being regarded as such by others, should be acknowledged. NPOs are an indispensable partner in drawing up such policies. For the same reason, self-regulation should be considered.

List of Abbreviations

AML	Anti Money Laundering
BPP	Best Practice Paper
CFT	Combatting Financing Terrorism
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
IN	Interpretive Note
NPO	Nonprofit Organization
PVS	Partner Vetting System
SRO	Self-Regulatory Organization
SR VIII	Special Recommendation VIII
TF	Terrorism Financing
UN	United Nations

Foreword

Terrorism causes untold material, physical, social, and psychological damage. As individuals and as a society, people must stand up to the terrorist threat. People must not, however, allow it to change the way they live and make them give up freedoms they enjoy. Resilience and prudence are of the essence. This applies equally when society is confronted with instances of nonprofit organizations being used for terrorist purposes. People need to address this problem without allowing it to fundamentally alter their way of life. The development and growth of civil society, and its contribution to many aspects of daily life, is one of the great accomplishments of our age. As a voice for the oppressed; a provider of medicine, education, and humanitarian aid; an advocate for worker's rights; a promoter of the arts, cultural understanding, and, more generally, an awareness of "the other," civil society has been an enormous force for good. While crucial in many ways to daily life in the developed world, civil society is simply indispensable in the developing world where it provides services elsewhere provided by government, whether medical care or education. Without nonprofit organizations, large segments of the populations in developing societies would not go to school or receive medical treatment.

In some instances, the global networks of nonprofit organizations have been used as a channel to raise and divert funds towards terrorist causes. Of course, such abuse needs to be tackled head-on, and NPOs and governments must do all they can to ensure that the funds are used as intended. Care should be taken, however, that action to counter such abuse is targeted and does not harm the healthy functioning of the NPO sector.

As recommended in the report of the United Nations (UN) Counter-Terrorism Implementation Task Force on Tackling Terrorism Financing, published in 2009, "States should avoid rhetoric that ties NPOs to terrorism financing in general terms because it overstates the threat and unduly damages the NPO sector as a whole." The World Bank recognizes the vital role of civil society in fostering development, but also realizes that safety and security are a prerequisite to development. As an international organization dedicated to the cause of development, the World Bank wishes to ensure that both objectives are fulfilled. The World Bank hopes this paper will provide a useful starting point for further discussion.

Consulate Rusagara
Director, FPDFS
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Introduction

The business of terrorism is fear and, in order to generate that fear, terrorism, like any other business, requires money. Money is required to buy safe-houses, to fund travel, to run training camps, to recruit new terrorists, to pay off officials, to procure weapons, to obtain false documentation and covers for sleeper cells, to promote the cause, and for many other ends. Those financial needs are met in different ways, drawing on both legal and non-legal sources. According to those at the forefront in combating terrorism financing (CFT), in particular the Financial Action Task Force against money laundering (FATF), one of the ways that terrorists obtain funds is through nonprofit organizations (NPOs). They draw upon examples of NPOs being used to raise, transfer, and divert funds for terrorist purposes.

The international community has taken various remedial measures in response. This paper aims to explain what lies behind the international action targeting NPOs and to clarify what the recognized international standard actually recommends in this respect—there is a lot of misunderstanding as to what is really required. This paper also discusses the issues involved in implementing or advising on CFT policy. It is important in taking action that countries do not overestimate the threat and that they are aware of all the possible consequences, even unintended ones. In many ways, the nonprofit sector of a country is a force for good and needs to be protected, rather than unnecessarily curtailed. Similarly, those who offer technical assistance to countries on this issue should advise and make recommendations that take into account possible adverse side effects of government action against NPO abuse. Applied in the wrong way, government measures can end up harming the NPO-sector and, ultimately, damage the wider counterterrorism effort.

After describing the types of cases mentioned in justification of remedial action and the rationale for specific measures recommended, this paper will attempt to highlight key issues surrounding regulation of NPOs for terrorism financing (TF) purposes and make some recommendations on how countries could sensibly deal with this question.

Examples of Abuse

The instances of abuse of NPOs for purposes of financing terrorism (TF) mentioned in FATF, government, media, academic articles, and documents cover NPOs raising, transferring, and disbursing funds for terrorist purposes. Below is a cross section of examples mentioned in justification of taking action.

NPOs Raising Funds for Terrorist Organizations

1. A number of religious groups in the countries A and B classified as charities and, therefore, entitled to tax-exempt status, raise funds for ostensibly apolitical projects in country C. In fact, significant sums go to causes controlled by members of a quasi-paramilitary body that is at the center of a protean network of front organizations. This structure facilitates arm's-length money-raising. Its arm in country A is a charity registered for nearly 30 years. Their appeal for earthquake victims raised more than 6 million USD.
2. In most countries with a significant diaspora population, members of an ethnic group established charitable organizations to raise funds for their causes. Although the charities solicited funds to assist civilians affected by the war, numerous inquiries, including investigations by intelligence services in country D, have found that a significant amount of the funds raised by charities were channeled to a designated terrorist organization for its military operations. The intelligence services of country D concluded that at least eight nonprofit organizations and five companies were operating in country D as fronts for the terrorist organization.

NPOs Transferring Funds for Terrorist Organizations

3. One of the most unlikely sources of Al Qaeda funding coming into the region was through the Foundation E based in the capital of country F. The foundation—which has offices in countries G,H, and I—was ostensibly established to address the needs of a small ethnic minority population in country F. Foundation E ran a school for grades 7–10 [...] Al Qaeda used the foundation for “significant money transfers” for both itself and for Jemaah Islamiyah. The foundation was believed to have laundered several million dollars for Al Qaeda; the school was receiving \$10,000 wire transfers each month in its account at a bank in country F.
4. An NPO with an office in country J came to the attention of the authorities through the submission of STRs by credit institutions on an apparent discrepancy between the stated objectives of the NPO and its actual expenditure. The NPO was also known to have a poor history of reporting to the authorities on tax issues. An investigation revealed that funds were being transferred from the NPO to apparently fictitious or shell entities and then being withdrawn in cash for onward transmission to illegal armed militants.

Diversion of Funds by Individuals or Branch Offices

5. Individuals, such as person K, are suspected of using NPO L and M, of which K is chairman, as vehicles to transfer large amounts of money to small radical groups. There is no evidence to suggest that person K is a member of Al Qaeda, but there is evidence that he has channeled funds to groups and organizations that have ties with Al Qaeda.”
6. “The office director for a nonprofit organisation in a beneficiary region defrauded donors from a donor region to fund terrorism. In order to obtain additional funds from the headquarters, the branch office padded the number of orphans it claimed to care for by providing names of orphans that did not exist or who had died. Funds sent for the purpose of caring for the non-existent or dead orphans were instead diverted to al-Qaida terrorists. In addition, the branch office in a beneficiary region of another nonprofit organisation based in a donor region provided a means of funnelling money to a known local terrorist organisation by disguising funds as intended for orphanage projects or the construction of schools and houses of worship. The office also employed members of the terrorist organisations and facilitated their travel.”¹

Complicit and Exploited NPOs

It may be analytically useful to draw a distinction between NPOs that act as a front for terrorist organizations and those that are being abused by others for nefarious purposes. This is, however, not the place to discuss the finer details of corporate liability and at what stage an act can be attributed to an organization. Suffice it at this stage to point out the difference between a “complicit NPO” (i.e., where it is acting as a front and the organization can be said to be involved in TF) and an “exploited NPO” (i.e., where it is abused by others). Of course, the line between the two will not always be clear, but it is important in determining remedial action. Within the category of exploited NPOs, one may be able to make a further distinction between those abused by outsiders and those abused by insiders. Stopping legitimate NPOs from being exploited by insiders may require a focus on their internal governance or financial controls. Abuse by outsiders may require improving access to information on partner organizations or beneficiaries. In the case of complicit NPOs, however, such action would not appear to address the problem.

It is unclear whether the majority of cases of the use of NPOs for TF purposes involve complicit or exploited NPOs. However, in its Best Practices paper, FATF states that: “*In certain cases* [author’s italics] the organisation itself was a mere sham that existed simply to funnel money to terrorists. However, *often* [author’s italics] the abuse of nonprofit organisations occurred without the knowledge of donors, or even of members of the management and staff of the organisation itself....” This suggests that in FATF’s view, at least, the majority of cases involve exploited NPOs. This is in contrast to some of those in the sector who appear to hold that the issue relates predominantly to complicit NPOs (see footnote 29).

There are many examples similar to those given above, but it is important to put them into perspective. As a percentage of terrorist revenues or funding, funds collected or transferred by NPOs might be significant—since there are no reliable figures either on the scale of terrorism funding or on NPO contributions, this is obviously impossible to determine. Nevertheless, as a percentage of total NPO turnovers, the sums involved are surely not. By any reckoning, the NPO sector worldwide is vast, encompassing millions of entities with annual expenditures of over \$1.3 trillion²—even the highest estimates for annual terrorism income amount to only a fraction of that.³ In the United States alone in 2006, NPOs received \$1 trillion in revenue, and private giving (by individuals, foundations, and corporations) reached \$295 billion.⁴ Whatever sum of that is diverted towards terrorist

purposes, it is only going to amount to a fraction of a percentage of total NPO funds. As was also recognized by the government of the United Kingdom in its charitable sector review “the scale of terrorist links to the charitable sector is extremely small in comparison to the size of the charitable sector.”⁵

Notes

¹ Combating the Abuse of Non-profit Organisations, International Best Practices, Financial Action Task Force on Money Laundering, 11 October 2002, p 8, available online at <http://www.fatf-gafi.org/dataoecd/39/19/34033761.pdf>.

² Lester M. Salomon, S. Wocieh and Associates, *Global Civil Society: Dimensions of the Nonprofit Sector*, vol. 2 (Bloomfield, CT: Kumarian Press, 2004), 15–16. This study, sponsored by Johns Hopkins University, only covers 36 countries; the real size of the global sector is larger.

³ The 9-11 Commission monograph on terrorism financing, still one of the most concise reports on the issue (not at the high end of the estimates), estimated annual Al Qaida funding at approximately 30 million USD per year (see National Commission on Terrorist Attacks upon the United States, Monograph on Terrorist Financing, p. 4, available online at http://www.9-11commission.gov/staff_statements/911_TerrFin_Monograph.pdf page 4).

⁴ See the press release on the *Nonprofit Almanac 2008*, “New Edition on Nonprofit Almanac Offers Detailed Portrait of an Expanding Sector,” The Urban Institute, available online at <http://www.urban.org/url.cfm?ID=901164>.

⁵ Review of Safeguards to protect the charitable sector (England and Wales) from Terrorist Abuse, Home Office and HM Treasury, December 2007, p16 online at http://www.homeoffice.gov.uk/documents/cons-2007-protecting-charities/Charities_consultation.pdf?view=Binary.

International Action

Special Recommendation VIII, the Best Practice Paper, and the Interpretive Note

Although many of the actual examples given above postdate the adoption of Special Recommendation VIII (SR VIII) on nonprofit organizations, it was with these types of cases in mind that FATF adopted it in October 2001 shortly after the attacks of September 11. The Special Recommendation states that countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism and ensure that NPOs cannot be misused by terrorist organizations posing as legitimate entities, conduits for terrorist financing, or to conceal the clandestine diversion of funds intended for legitimate purposes to terrorist organizations. In the Best Practice paper that followed, FATF underlined the need to “safeguard and maintain the practice of charitable giving and the strong and diversified community of institutions through which it operates whilst advocating a number of measures focusing on financial transparency, programmatic verification, and the administration of NPOs.”¹ The broad and general language leaves a lot of room for interpretation and does not stipulate what precise measures countries are to take. Consequently, in an attempt to provide clarification and after a long debate between its members, FATF issued an Interpretive Note (IN) in February 2006 to define what constitutes an NPO and what exactly is required under SR VIII. Both the text of the special recommendation, the Best Practice Paper and the Interpretive Note are included as an appendix to this paper.

The IN lists those characteristics that may render NPOs vulnerable to abuse:

- They enjoy the trust of the general public—implying that donors and government authorities may not be sufficiently vigilant in their dealings with NPOs.
- They have access to considerable sources of funds and they are often cash-intensive—implying that, as a matter of course, they move large amounts of money, and, when they deal in cash, do not leave a financial trace.
- They may have a global presence that provides a useful framework for national and international operations and financial transactions, often within or near those areas most exposed to terrorist activity—not by accident, these are often areas of humanitarian need.
- Depending on the legal form of the NPO and the country, NPOs may be subject to little or no governmental oversight, or few formalities may be required for their creation.²

An NPO is defined as “a legal entity or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of ‘good works.’”³

Taken together, the Special Recommendation, the IN, and the BPP recognize the vital role played by the NPO sector and that any measure taken to address the financing of

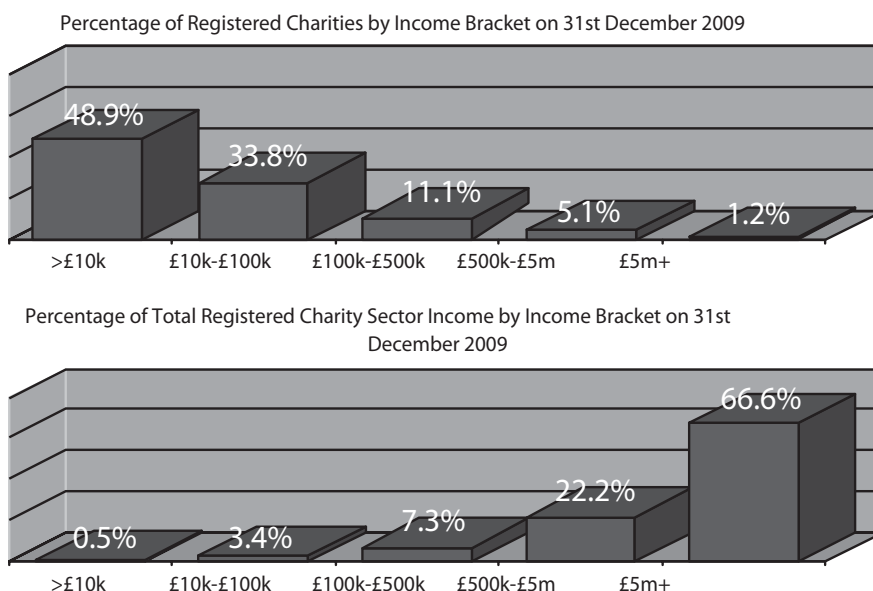
terrorism should not disrupt or discourage legitimate charitable giving. This is an important point that should be borne in mind by all those who deal with the issue—effectiveness of any measures adopted in implementation of SR VIII should also take into account whether measures taken have discouraged or disrupted legitimate charitable giving. The measures are as much about protecting the NPO sector against abuse as they are about identifying and targeting possible culprits. It recognizes possible tension that may exist between taking such action and charitable giving: “Action taken [to address terrorism financing] should to the extent reasonably possible avoid any negative impact on innocent and legitimate beneficiaries.” Government oversight should be “flexible, effective and proportionate to the risk of abuse. Mechanisms that reduce the compliance burden without creating loopholes should be given due consideration” (BPP). On the measures to be taken to prevent or detect such abuse, the IN says in general terms that they should promote transparency and engender greater confidence that charitable funds and services reach intended legitimate beneficiaries, both across the donor community and the general public. Specifically, this means: a) outreach to the sector, b) supervision or monitoring of the sector, c) effective investigation and information gathering, and d) effective mechanisms for international co-operation.

Of these four components, the second, supervision or monitoring, has proved to be most contentious and open to debate. Collectively, the measures proposed under this heading will be referred to as “supervisory measures.” The IN stipulates that countries should be able to demonstrate that a list of more specific standards apply to NPOs that account for a significant portion of the financial resources under the control of the sector and a substantial share of its international activities. This echoes the BPP, which states that “small organisations that do not raise significant amounts of money from public sources and locally based organisations or organisations whose primary function is to redistribute resources among members may not necessarily require enhanced government oversight.” In limiting the scope in this way, FATF is attempting to apply a risk-based approach, focusing its efforts only on those institutions that might pose a potential risk, thus minimizing any compliance burden. Whether it is thus targeting the right group is a matter for debate (see below); there may be a broader range of risk factors that is relevant.

The specific measures proposed as supervisory measures focus on the transparency and accountability of the NPO. Relevant information on the identity and background of the NPO’s management and owners, and on its objectives and financial statement, should be maintained and made available to appropriate authorities. NPOs should have internal controls ensuring their spending is in accordance with the purpose and objective of the NPO. They should also make a best-efforts attempt to confirm the identity, credentials, and good standing of their beneficiaries and associate NPOs. Finally, they should be registered or licensed, subject to monitoring by appropriate authorities (which may include self-regulatory organizations), and subject to sanction for non-compliance.⁴ Underlying the recommended action appears to be the idea that ensuring transparency of financial flows and, to the widest extent possible, the bona fides of all those in any way associated with the NPOs will allow for early detection by competent authorities of possible instances of TF by NPOs. In addition, it will provide useful information to those investigating NPOs once they are under suspicion, and it may prevent those planning to use NPOs for TF purposes from putting their ideas into action.

Before proceeding to discuss the arguments put forward by those who have criticized taking action against NPOs, it is important to repeat the point about the restricted scope of the supervisory measures. An example will illustrate this point.

FATF defines the NPO as a *legal* entity or organization (i.e., excluding the many informal organizations that under many definitions would qualify as an NPO) that *primarily engages in raising or disbursing funds* (i.e., excluding advocacy organizations and many others active in the expressive field⁵) for charitable purposes. Having thus excluded a substantial part of



Source: See Facts and Figures on the UK Charity Sector available online at http://www.charity-commission.gov.uk/About_us/About_charities/factfigures.aspx.

Note: The figures are based on the Annual Gross Income reported by charities in their Annual Returns. 7% of registered charities have not provided this information and are excluded from the figures. At an aggregate level the total income figures for all registered charities inevitably includes an element of double counting. Double counting arises when resources are transferred between charities and counted in both.

what is commonly considered to constitute the nonprofit sector the supervisory measures are then further limited to those organizations accounting for a significant portion of the financial resources *and* a substantial share of the sector's international activities. In other words the supervisory measures apply to a subset of a subset of what most countries would regard as their nonprofit sector. To show how much of a subset we are talking about, the following figures on the financial size of registered charities in 2009 in England and Wales may be illustrative.

As is clear from the above diagrams, 6.3 percent of the total number of registered charities (i.e., the total percentage from £500,000 upwards) accounts for almost 90 percent of the total revenue. When one takes into account the fact that there are a substantial number of non-registered charities at the low end of the scale⁶ (i.e., < £5,000) and that there are some charities at the high end of the scale that do not engage in international charity, the total percentage of interest to FATF for supervisory measures is even lower than 6.3 percent—obviously assuming that 90 percent of total revenues qualifies as “significant” for the purposes of FATF's IN.⁷ It is important to emphasize this point, since many who criticize the FATF action on this point appear unaware of it.⁸

Notes

¹ See the Financial Action Task Force on Money Laundering, “Combating the Abuse of Non-Profit Organizations, International Best Practices” available online at <http://www.fatf-gafi.org/dataoecd/53/53/34260889.pdf>.

² The U.K. Charity Commission adds to this that “charities are often engines for social change that attract people committed to making change happen and are powerful vehicles for bringing people together for a common purpose and collective action, and may inadvertently provide a ready-made

social network and platform of legitimacy for terrorists or terrorist sentiments.” See “Charity Commission, Counter Terrorism strategy” (July 2008), 5, <http://www.charitycommission.gov.uk/Library/investigations/pdfs/ctstext.pdf>.

³ A political party or a terrorist organization not being established for carrying out “good works” would not be covered by this definition.

⁴ A noteworthy omission is the absence of rules on the hiring of employees by NPOs. For exploited NPOs wishing to make sure they are protected against abuse, this is surely one of the most important issues.

⁵ The term “expressive” is derived from the distinction (see Salomon et al., *op. cit.*, 24) between nonprofit organizations that have a “service” function and those that serve an “expressive” function. It is used here to denote organizations that provide avenues for the expression of cultural, spiritual, professional, or policy values and beliefs.

⁶ All charities with an income over 5,000 GBP are obliged to register with the Charity Commission, whereas it is voluntary for those with a figure below this number.

⁷ Comparative data for other countries could not be found. Although the exact percentages for other countries will obviously be different, it is assumed that for the majority of developed countries—and thus of the FATF member countries—the ratios are similar, i.e., a small percentage earn the vast majority of total income.

⁸ As indeed many who evaluate application of SR VIII appear to be as well. A cursory review of evaluations undertaken by FATF and regional bodies demonstrates that many assessors who evaluate SR VIII do not take into account the fact that the recommendation addresses only a particular (limited) class of NPOs and rather evaluate the application of the measures proposed under SR VIII to the entire NPO sector rather than to the subset described above.

Criticism of International Action

The discussion will now proceed to objections to the type of measures discussed above and the assumptions underlying them. While not covering each and every criticism, it does represent a relevant cross section of the critique most frequently raised. Again, the arguments below are merely a reiteration of opinions as expressed in a wide variety of online journals and media, not necessarily an endorsement.

Harming the Sector and the Cause

In discussing the quality of the available literature on NPO abuse, a recent report commissioned by the European Commission noted that “the current concern about terrorism has not helped improve the quality of available information. Instead, it has tended to exacerbate the problem of journalistic and sensational media accounts of particular cases leading to a plethora of unwarranted inferences and inductions in the press.”¹ “Sensational media accounts” may affect more than only the quality of information.

Donor caution

Highlighting the possible links between charities and terrorism has not only affected NPOs themselves but also had an impact on the donor community. Since the criminalization of the financing of terrorism renders all those who knowingly contribute towards terrorist causes, directly or indirectly, liable to criminal charges, many donors have become more cautious about donating to those NPOs that operate in environments or countries associated with terrorist activity, fearing that they (i.e., the donors) might themselves be held liable of terrorism financing. Certainly, in the immediate aftermath of September 11, this resulted in a drop in donor funds. As testified by a U.S. official before a Senate Committee: “The larger balance [of the success of counterterrorism measures] is found in the wariness, caution, and apprehension of donors; in the renunciation of any immunity for fiduciaries and financial intermediaries who seek refuge in notions of benign neglect and discretion, rather than vigilance.”² Although it is difficult to estimate the drop in donor contributions since September 11, there is a belief that such a drop did occur. Muslim Charities in particular appear to have suffered a decline in funding.³

Use of FT rhetoric for other ends

In recent years, countries all around the world have introduced laws and regulations restricting operations of the NPO sector.⁴ Citing terrorism concerns, a number of governments have imposed restrictive legislation upon the NPO sector—not simply attempting to establish transparency, but seeking in effect to control the activities and the funding of NPOs. In some instances, prior government approval is required before international funding may be received.⁵ Indeed, in one instance, a government official explicitly cited provisions in domestic legislation, ostensibly intended to establish some form of transparency in the NPO sector for TF purposes, as an effective means of ensuring that grass roots political opposition was denied funding.⁶ In a report examining the possible

contradiction of counterterrorism measures that can hinder the work of countering terrorism by the Dutch development agency Cordaid, the Fourth Freedom Forum, the Kroc Institute for International Peace Studies at the University of Notre Dame and civil society partners in Europe, Asia, Latin America and Africa, the authors observe that “Organizations and movements that challenge the abusive policies of unaccountable governments inevitably arouse the ire of those in power, but in recent years such pressures have mounted as policy makers have appropriated the language of counterterrorism to intensify their attacks against civil society-based critics.⁷ Needless to say, such measures, the real target of which often appears to be the political opposition⁸ are not envisaged or recommended by FATF.

Alienating NPOs in the fight against terrorism

A further objection to associating NPOs with terrorism in a generalized manner is that it alienates what should be a valuable partner in the fight against terrorism and extremism. Far from being considered primarily as possible risks for TF, NPOs should rather be regarded as important allies. In the UN Global Counterterrorism Strategy adopted on September 8, 2006, the General Assembly resolves to undertake measures aimed at addressing the conditions conducive to the spread of terrorism, in order, amongst other things, “to promote dialogue, tolerance and understanding among civilizations, cultures, peoples and religions.”⁹ In this regard, it welcomes the initiative on the Alliance of Civilizations by the Secretary General, which is “to recommend a practicable programme of action for States, international organizations and civil society aimed at promoting harmony among societies.”¹⁰ Clearly civil society organizations—NPOs—have a valuable role to play in helping to curb extremism and “contributing to strengthening institutions of democratic governance including (...) the protection of human and civil rights and mechanisms for peacefully resolving conflicts.”¹¹ A crucial part of the fight against terrorism is to build social structures and to establish or maintain dialogue between communities to counter radicalization and feelings of exclusion. Many charities carry out these activities by delivering aid and by other means. CFT measures that do not take this into account may cause net harm. The abovementioned report on possible contradiction of counterterrorism measures notes that: “Many of the organisations that work against extremism by promoting development and human rights are themselves being labeled extremist and are facing constraints in their ability to operate.”¹² The question then arises of whether this role can still be fulfilled if the sector itself is treated with caution and suspicion. It may appear a moot point, but it becomes real when one considers the vital role played by Islamic charities in many Muslim countries and communities. Some banks, given their global reach and the possible legal, regulatory, and reputational repercussions if implicated in terrorism financing, have stated that they will not accept a client’s instruction to transfer money to an Islamic charity, whether or not that charity appears on a list of terrorist organizations.¹³

Preventing humanitarian assistance

NPOs often operate in highly vulnerable areas or conflict zones in which terrorist organizations operate as well. Sometimes the territory is actually controlled by terrorist organizations, making it all but impossible not to, at least, be in contact with such organizations if one wishes to work there. What, for instance, is an NPO to do in the event of a humanitarian disaster occurring in a zone controlled by a terrorist organization? Would interaction with a terrorist organization under those circumstances imply that the NPO is itself supporting terrorism? The question came up in the case of the tsunami which struck in South and East Asia in December 2004. One of the devastated countries was Sri Lanka. Part of the affected area was, at that time, controlled by the Liberation Tigers of Tamil Elam (LTTE), an organization designated as terrorist in many countries, including the United States. The LTTE was the de facto government of the area and controlled all traffic. Are humanitarian organizations prohibited from taking action because it would entail

cooperation—or at least interaction—with such an organization, whereby, in this case, some of the 40,000 people affected would have been deprived of aid? Such a consequence would appear undesirable. Some accommodation will have to be found to ensure that aid can be provided under such circumstances, even though it may mean implementing further controls to protect this aid from abuse.¹⁴ Ensuring aid is only delivered in kind—as opposed to being financial—and controlling the delivery thereof, for instance, already limits the possibility for abuse.

In addition, what happens when legitimate NPOs do not act or are prevented from doing so? A U.S. Treasury report on the 2005 Kashmir earthquake¹⁵ said that terrorist organizations were sometimes the first on the scene, remained prominent throughout the emergency and seem to have been effective in their delivery of aid. It reports a survivor saying that, if the terrorist organization had not helped her, she would have died. Focusing on CFT—rather than creating a larger, stronger sector—could leave a vacuum for terrorist organizations to fill and a lingering resentment by survivors against the government, either for failing to help them or directing its attention to counterterrorism rather than humanitarian relief.¹⁶

Government Regulation Is Inappropriate

A second strand of argument against the type of action proposed above questions whether government regulation is the appropriate response to what, from the NPO sector perspective, is a very exceptional phenomenon. Surely, so the reasoning goes, it is the role of law enforcement (or possibly intelligence services) to investigate and prosecute.

Regulation not effective

The case is particularly relevant for complicit NPOs. How can government regulation be a useful tool against an extremist organization posing as a legitimate NPO? Do they not simply disappear from sight when regulation is introduced and carry on their activity “underground”—i.e., unregulated and invisible on the government’s radar? Regulatory measures can be seen as only imposing extra burdens on many bona fide organizations while not affecting those organizations intent on doing harm. As the executive director of an international foundation put it: “why do we have these rules if there are no apparent cases of *inadvertent* support for terrorism?”¹⁷

For the category of exploited NPOs, although one may be able to make a case for regulatory measures that seek to enhance transparency,¹⁸ one may still question how much enhanced scrutiny would achieve. In reviewing all cases of alleged diversion of funds for terrorist purposes, a U.S. report in 2004 found that there were “none that involve a diversion of funds granted by a U.S. grant maker to a foreign recipient organization, where the diversion would have been uncovered but for the lack of appropriate due diligence and oversight procedures.”¹⁹ Quite apart from that, one can still debate whether the imposition of government regulation is really necessary to achieve this aim. As one observer noted “Charitable organizations are already vigilant, already taking steps; many are already going beyond the law. Many are taking extra steps just to be sure their charitable assets are not being diverted.”²⁰

We are, as of yet, unaware of any criminal cases in which instances of terrorism financing were detected as a result of the type of supervisory measures discussed above.²¹ Anecdotal information suggests, rather, that it is financial intelligence that is essential. As one former employee from a Financial Intelligence Unit (FIU) said: “We at the FIU identified a number of NPOs that are involved in terrorist financing, but we discovered them not through any intensified NPO scrutiny or regulation, but rather by trawling through the wire transfer data that was routinely reported to the FIU by all financial institutions, and by comparing and contrasting reports from a wide range of institutions. Without the benefit of the wire

transfer data it is very doubtful that we would have been able to identify instances of TF whether carried out by NPOs or any other body.”²² Of course, the preventive effect of the types of measures envisaged will always be impossible to ascertain. One can hardly expect to prove that certain individuals did not engage in certain activities because of an existing regulation.

The argument made by those in favor of regulating NPOs for TF purposes is that the introduction of regulation usually entails the introduction of concomitant regulatory powers to enforce the regulation. In the case of NPOs, the IN explicitly recommends such powers, giving public authorities a tool for taking early action before any possible terrorist abuse can take place. In cases where, originally, no public action was possible until a crime had been committed, a regulator can now act to disrupt by taking supervisory enforcement action. So, where an NPO has not kept its financial records in order or authorities find worrisome information about associates of the NPOs, the regulator can now engage them earlier rather than later: “effective regulation involves putting a strong emphasis on giving support and guidance to charities to prevent problems and abuse occurring in the first place.”²³ The argument then is that the introduction of regulation is not so much about the apprehension of perpetrators as it is about widening the possible tools available for government action in order to disrupt activity to prevent any possible terrorist abuse taking place.

However, the other argument against the imposition of regulation, namely that it drives the targeted group or the targeted activity “underground,” is not affected by the above consideration.²⁴ If, indeed, the effect of regulation is to drive the groups or activities out of the public eye, it will require extra law enforcement efforts to detect them and take action.²⁵

Regulation not justified

An argument closely linked to the one discussed above is that a very small percentage of cases, proportionally, does not justify government regulation, because—unlike, for instance, the regulation of other parts of society like the financial sector—it infringes upon a basic human right.

The right at issue here is the freedom of association that underpins the existence and activities of many NPOs. In this view, the argument is that government regulation of NPOs restricts this right by imposing obligations on the NPO sector. According to article 22 of the International Convention on Civil and Political Rights,²⁶ to which 165 states are now party,²⁷ restrictions on this right are justified only under limited, defined conditions, among others, in the interest of national security or public safety. They cannot be invoked as a reason for imposing limitations to prevent relatively isolated threats to law and order.²⁸ In case law on article 11 of the European convention,²⁹ the European Court on Human Rights stipulates that exceptions must be “construed strictly,” that only “convincing and compelling reasons” can justify restrictions that must be “proportionate to the aim pursued and that there must be relevant and sufficient evidence for decisions based on an acceptable assessment of the relevant facts before a restriction can be justified.”³⁰ For the critics who believe that some of the measures taken by certain governments, purportedly to address CFT concerns, indeed do limit the right to the freedom of association, the argument for their justification becomes more problematic the more isolated the instances of financing of terrorism through NPOs are.

How Useful Are the Specific Measures Proposed?

The above arguments discuss in a general way what the effects of the imposition of regulation are or might be. The following directly addresses the implications of the financial transparency and due diligence measures proposed in the IN.

Apart from seeking to ensure that pathways of information are established between government authorities and the NPO sector—whether by way of registration or licensing—the IN imposes obligations on NPOs to ensure transparency in their funding, their operations, and the information that is made available on all those associated with the organization, donors, beneficiaries, and partner organizations. It is a “best-efforts,” not a “results,” obligation—meaning that NPOs should make the best attempt, reasonable under the circumstances, to establish the identity of the relevant persons and cannot be held in breach of this obligation merely because they have not established the identity. As far as the financing is concerned, the NPO is to put controls in place to ensure that all funds are accounted for in accordance with the NPO’s objectives.

Approach to risk

As noted, FATF’s definition of NPOs differs from the way in which many countries have defined NPOs for the purposes of their CFT legislation. The total number of organizations upon which many countries impose their CFT obligations is often wider than the definition given by FATF. FATF’s definition considerably limits the circle of organizations to which measures should be applied. As was shown above, in the United Kingdom, 6.3 percent of registered charities account for approximately 90 percent of the income of the charity sector. The question is whether or not, in deciding to focus the supervisory measures on this numerically small group, FATF is targeting the relevant organizations. It would, for instance, most certainly include those international organizations well known around the world for their charitable activity. Are they indeed most likely to be at risk for terrorist abuse? Does their diversity of operations and global presence imply a higher risk or are they, precisely because they are bigger and tend to be more professionally organized, more likely to have taken internal risk mitigation measures that would prevent such abuse? A survey of charities in England and Wales found that smaller charities, with a turnover of less than £1 million per year were less likely to have fraud policies, risk assessments, and control assessments in place than bigger charities,³¹ possibly rendering them more vulnerable to abuse. In addition, it should be noted that none of the examples above and none of the many other examples reviewed included any of the bigger, well-known charity organizations involved in instances of (inadvertently) supporting terrorist financing.

In so limiting the scope of its supervisory measures, FATF’s approach is also slightly at odds with its own recommendation to countries that they should undertake a domestic review of the sector in order to identify features and types of NPOs that, by virtue of their activities or characteristics, are at risk of being misused for terrorist financing. Surely, the whole point of such an exercise is to allow countries to decide for themselves where the risks are (and presumably impose the recommended supervisory measures upon that part of the sector) without having to limit themselves to a predefined sub-category. Applying a risk-based approach implies that countries themselves identify their own risks and apply their measures accordingly. Such an analysis may well show that the real risks are at the fringes of the sector with NPOs operating on a marginal budget.

A “best-efforts” approach

Although no one will argue with the basic idea that an NPO should know how its funds are spent—if only to justify the donor’s trust—and whom it is working with, the real question is how far those obligations should go. Do the controls demand that an NPO has to verify, on site, how funds are spent? What would that imply for an NPO in a donor country working with NPOs overseas? Can it rely on a statement from the overseas NPO? Or would it be required to enlist the services of an outsider to check on how the funds are spent?

As a high-level document,³² the IN cannot be expected to address those questions. Exactly where the line is drawn, however, has significant financial consequences for the NPO

sector. A duty on an NPO providing funds to a project abroad run by a partner organization to verify how funds were spent and who exactly all the decision makers within the partner NPO are and whether they have criminal records or not, may prove very costly and divert funds to activities that are not essential to the fulfillment of the NPO's legal mandate. The reality is that much of the required information is not readily available in a large part of the developing world.³³ Furthermore, "even if a charity could amass facts (which will be hard in many humanitarian settings, cash economies, and poor societies) there are no objective standards against which to test them."³⁴ Quite apart from the availability and reliability of the information, the resources needed to conduct the required due diligence should also be considered; grant-making organizations with small budgets may be especially affected because they lack the personnel or resources to engage in these procedures.³⁵

Breach of trust

Resources are, however, only part of the issue. To a large extent, international grant-making has to rely on cooperation between different NPOs—very few can afford to have a completely global network. In furthering the common good, organizations join forces—donor organizations in the richer parts of the world often rely on local organizations in the developing world to carry out projects. The cement that holds that cooperation together is trust. A thorough examination of your counterparty's credentials (particularly where disparities of power and influence exist) can severely damage that trust and the goodwill that underlies strong and spontaneous cooperation. The earlier-mentioned report on the possibly counter-effective effects of certain measures aimed at combatting terrorism notes that "Requiring nonprofit groups to collect personal information on their partners puts them at risk of being perceived as law enforcement or intelligence agents."³⁶ Cordaid, a big Dutch development organization with an international network of almost a thousand partner organizations in 36 countries in Africa, Asia, and Latin America, recently refused a USAID co-financing grant for a partner group in North Kivu in the Democratic Republic of Congo because of the rigid conditions attached, including participation in a partner vetting system³⁷ and declined a financing opportunity in Pakistan because of a refusal to compromise relationships of trust with local partners.³⁸ In sensitive countries, "some grant-makers are already beginning to experience hostility and suspicion from prospective grantees—particularly non-profit organizations that advocate for political and economic reform."³⁹ In addition, charities operating abroad and foundations funding foreign organizations. In the U.S. context one observer argued that imposing the PVS [Partner Vetting System] is "using a flame thrower to kill an ant. And more than ants may be killed if the PVS is implemented" may be perceived as agents of the government because of counterterrorism measures.⁴⁰ And it is claimed, here again, that the results of such measures may prove counterproductive.

Notes

¹ Matrix Insight, "Study to Assess the Extent of Abuse of Non-Profit Organisations for Financial Criminal Purposes at EU level" (3 April 2008), commissioned by the European Commission, Directorate-General Justice, Freedom and Security, available online at http://ec.europa.eu/homeaffairs/doc_centre/terrorism/docs/study_abuse_non_profit_orgs_for_financial_criminal_purposes_avril09.pdf.

² Written Testimony of David D. Aufhauser, General Counsel, Department of the Treasury before the Senate Judiciary Committee Subcommittee on Terrorism, Technology and Homeland Security June 26, 2003 2:00 p.m. The United States Senate, p11, available online at <http://www.ustreas.gov/press/releases/reports/js5071.pdf>.

³ See, for instance, "Muslim Charities Say Fear Is Damming Flow of Money," *Washington Post*, August 9, 2006. According to the U.K. Charity Commission, there is no evidence to support this fact for the United Kingdom.

⁴ Doug Rutzen and Cathy Shea, "The associational Counter Revolution" *Alliance* 11, no. 3 (September 2006), p. 27, available online at <http://www.icnl.org/knowledge/pubs/AssocCounterRevol.pdf>. See

also, "Defending Civil Society, A report of the World Movement for Democracy" (February 2008), co-authored by the International Center for Not-for-Profit Law (ICNL) and World Movement for Democracy Secretariat at the National Endowment for Democracy available online at <http://www.wmd.org/documents/Defending%20Civil%20Society%20%20English.pdf>.

⁵ See *Global Trends in NGO law, a quarterly review of NGO legal trends around the world* 1, no. 1 (March 2009), available online at <http://www.icnl.org/knowledge/globaltrends/GloTrends1-1.htm>.

⁶ Author's conversation with government official, March, 2005.

⁷ David Cortright with George A. Lopez, Alistair Millar and Linda Gerber-Stellingwerf, "Friend not Foe: Civil Society and the Struggle against Violent Extremism," a report to Cordaid from the Fourth Freedom Forum and Kroc Institute for International Peace Studies at the University of Notre Dame, p. 3, available on line at http://www.fourthfreedom.org/pdf/08_10_Friend_Not_Foe.pdf

⁸ See, for example, J. Howell, "The Global War on Terror, Development and Civil Society", *Journal of International Development* 18 (2006): 128.

⁹ See "Resolution: The United Nations Global Counter Terrorism Strategy" adopted by the General Assembly on September 8 2006 UN Doc A/Res/60/288, available online at <http://www.un.org/terrorism/strategy-counter-terrorism.shtml>.

¹⁰ See "Secretary General Announces composition of High Level Group for Alliance of Civilizations" 2 September 2005, UN Doc SG/SM/10073/Rev.1*, available online at <http://www.un.org/News/Press/docs/2005/sgsm10073.doc.htm>.

¹¹ F. Barnett Barron, "Deterring donors: Anti Terrorist financing rules and American Philanthropy," *The International Journal for Not-for-profit Law* 6, no. 2, (January 2004), http://www.icnl.org/knowledge/ijnl/vol6iss2/special_5.htm.

¹² Cortright et al., op.cit. p. 1.

¹³ James Shaw Hamilton, 2007 "Recognizing the Umma in Humanitarianism: International Regulation of Islamic Charities," in *Understanding Islamic Charities*, ed. Jon Alterman and Karin von Hippel, p. 15–31, Washington, D. C., CSIS Press.

¹⁴ For a wider discussion of this particular, point see "Testimony at an Oversight Hearing on Amendments to the Material Support for Terrorism Laws, before the Subcommittee on Crime, Terrorism and Homeland Security of the House Judiciary Committee" (10 May 2005), available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_house_hearings&docid=f:21139.wais. For a discussion on the legal aspects of this issue under U.K. law, see "The U.K.'s "Anti-Terrorist" Finance Regime and Its Implications for the Non-Profit Sector," Legal opinion by Edward Fitzgerald QC and Caoilfhionn Gallagher (7 December 2006) in appendix to Nolan Quigley and Belinda Pratten, "Security and Civil Society, The impact of counter-terrorism measures on civil society organizations," Report of Advisory Council set up by National Council for Voluntary Organisations (11 January 2007), available on line at http://www.ncvo-vol.org.uk/uploadedFiles/NCVO/Policy/Civil_Society_and_Participation/2007%2001%2024%20Security%20and%20Civil%20Society-A%20report%20from%20NCVO.pdf.

¹⁵ Typologies and Open Source Reporting on Terrorist Abuse of Charitable Operations in Post-earthquake Pakistan and India, published online by the US Department of Treasury, available at http://treas.gov/offices/enforcement/key-issues/protecting/docs/charities_post-earthquake.pdf

¹⁶ The point also came up in the context of the floods in Pakistan in August 2010. At a special meeting of the UN General Assembly, Pakistan's foreign minister, Shah Mahmood Qureshi said that the international community must help address the upheaval created by the floods. "If we fail, it could undermine the hard-won gains made by the government in our difficult and painful war against terrorism. We cannot allow this catastrophe to become an opportunity for the terrorists." See *In Pakistan, Militants Use Flood Aid to Seek Support*, Corey Flintoff, August 23, 2010, available online at <http://www.npr.org/templates/story/story.php?storyId=129379169&ft=1&f=1004>.

¹⁷ Nancy Billica, "Philanthropy Counter Terrorism and Global Civil Society Activism", prepared for the London School of Economics Workshop on Aid, Security, and Civil Society in the Post-911 Context, 28-29 June 2007, p10, available on line at <http://www.lse.ac.uk/collections/CCS/events/conference/Billica.pdf>, 10. The discussion is, of course, by no means exclusive to NPOs and terrorism financing. Lawyers are objecting to the introduction of AML measures in their profession because, they say, while there are undoubtedly cases of money laundering involving lawyers, there are no cases of unwitting involvement in money laundering by lawyers, and only those cases can usefully be dealt with by regulation.

¹⁸ The argument being that, if the NPO itself is legitimate, one can reasonably assume that those in charge will do everything possible to stop being exploited by others for terrorist purposes. The measures proposed might lead to the discovery of incidents or malpractices that would otherwise be

overlooked. Due diligence of a beneficiary might reveal that there is reason for caution and lead to the imposition of extra safeguards to guarantee that money is being spent correctly.

¹⁹ Victoria B. Bjorklund, "Terrorism and Money Laundering: Illegal Purposes and Activities" (paper delivered for the National Center on Philanthropy and the Law, October 28, 2004), available at http://www3.law.nyu.edu/ncpl/library/publications/Conf2004_Bjorklund_DRAFT.pdf.

²⁰ Billica *op. cit.*

²¹ Of course, that is not to say such cases do not exist. There may be very valid reasons for law enforcement and intelligence agencies not wishing to disclose how an instance of abuse was detected.

²² E-mail to author, August 18, 2008.

²³ U.K. Charity Commission Counter Terrorism Strategy, page 4, online at <http://www.charity-commission.gov.uk/Library/investigations/pdfs/ctstext.pdf>

²⁴ See, for example, Mark Sidel, "Counter-terrorism and the enabling Legal and Political environment for Civil Society" in *The International Journal of Not-for-Profit Law* volume 10, issue 3, June 2008, available online at http://www.icnl.org/knowledge/ijnl/vol10iss3/special_2.htm, who in discussing the Guidelines issued by the U.S. Treasury Department to U.S.-based charities states: "And the Guidelines carried the risk that legitimate and well meaning charities would struggle to comply with standards while less professional or less well meaning groups might just ignore them." Similarly, see Mohammed R. Kroessin, "Islamic charities and the 'War on Terror': dispelling the myths," *Humanitarian Exchange Magazine*, Issue 38, June 2007 available online at <http://www.odihpn.org/report.asp?id=2890>: "this switch away from established charities may have further weakened the transparency and accountability of charitable donations."

²⁵ Ironically, attempts to close down or control formal charities may have had precisely the opposite effect by forcing charitable giving into less regulated channels. Charity Commission, *op. cit.* (p.8), where it states: "We must also be alert to the unintended risk that a higher burden of regulation may encourage money to be donated to unregistered organisations or to others overseas and therefore beyond the regulatory scope of the Commission." See also, Ibrahim Warde, *The Price of Fear, the Truth behind the Financial War on Terror*: p. 130, Berkeley, University of California Press, 2007 "post-September 11 policies proved mostly counterproductive; they weakened mainstream controllable charities, while building up informal, unchecked and potentially dangerous charitable and donor networks."

²⁶ See also article 11 of the European Convention for the Protection of Human Rights and Fundamental Freedoms and article 16 of the American Convention on human rights.

²⁷ As at November 6, 2009, see http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtds_g_no=IV-4&chapter=4&lang=en

²⁸ OSCE/ODIHR Key guiding principles of freedom of association with an emphasis on Non Governmental Organisations, page 5 as quoted in *Defending Civil Society, A report of the World Movement for Democracy*, *op. cit.*, p. 24.

²⁹ Although legally speaking, this case law is relevant only to parties to the European Convention, the virtual identical language of this article and art 22 ICCPR and the standing of the ECHR render it of more than merely European significance.

³⁰ See *Sidiropoulos and others v. Greece*, 10 July 1998, (57/1997/841/1047) and *United Communist Party of Turkey and other v Turkey*, 30 January 1998(133/1996/752/951).

³¹ Matrix Insight, *op. cit.*, p. 28.

³² Given the decision-making process within FATF and the number of members, FATF recommendations tend to address principles and objectives rather than be technically prescriptive in how those are to be achieved.

³³ Barnett F. Baron, *op. cit.*

³⁴ James Shaw-Hamilton, *op. cit.*

³⁵ Nancy Billica, "Philanthropy & Post-9/11 Policy Five Years Out: Assessing the international impacts of counter terrorism measures", p.15. (December 2006), available online at http://www.urgentactionfund.org/assets/files/philanthropy_at_risk/Philanthropy-Post%209-11_final.pdf. To put the issue of NPO resources into some more perspective, only about 20 percent of the 800,000 associations in France have one employee or more.

³⁶ David Cortright, et al, *op. cit.*, p. 14.

³⁷ *Ibid.*

³⁸ Cortright, et al. *op. cit.*

³⁹ Barnett Barron, *op. cit.*

⁴⁰ OMB Watch and Grantmakers without borders, "Collateral Damage, How the War on Terror Hurts Charities, Foundations and the People they serve," (July 2008), 6, <http://www.ombwatch.org/npadv/PDF/collateraldamage.pdf>.

Conclusions and Recommendations

The international and national reaction to instances of terrorism financing by NPOs has been considerable. Despite the energy put into this effort, we are not aware of examples in which measures proposed by individual countries in implementing SR VIII and the IN, or similar national legislation, have resulted in detecting or deterring cases of terrorism financing. Part of the explanation for this may be that the measures are too recent to have become fully effective, that such instances have not been made public, or that the measures are, in essence, meant to be preventive in nature (the effect of which is, inherently, impossible to measure).¹

Regulation: Use Existing Frameworks

The rarity of instances of terrorism financing by NPOs, when contrasted against the enormous scope of the sector, does raise the question of whether, *in and of itself*, government regulation is the most appropriate response. To be clear, this is not to belittle the significance of the issue; rather, it is to question the nature of the response.

This does not mean, however, that regulation—whether by government or through the non-profit sector itself—has no role to play. So far, the debate about terrorism financing and NPOs has dealt with the issue in isolation, as if it were a wholly new type of problem, not connected to other NPO-related problems and, requiring a radically different approach to NPOs. This is not the case. Concern over use of funds by NPOs is well known and has already led to widespread regulatory and self-regulatory action aimed at enhancing the transparency and integrity of the NPO sector in many countries. To a very large degree, these measures address terrorist financing concerns as well. A report on the European Union’s efforts in the fight against terrorist financing noted that strengthening anti-fraud measures, and other measures to increase financial oversight and reporting, was considered by many to be the more effective approach to addressing TF concerns.²

In advocating any action to address TF concerns, it is very important to be aware of the regulatory frameworks already in existence. This point deserves extra emphasis, since many of those involved in Anti Money Laundering (AML) and CFT do not appear to be aware of these frameworks and of the sources already available to government to obtain information on NPOs. In virtually all countries, NPOs already engage with the governments in various ways: when they need or want to register with the government, when they seek tax privileges, or when raising money from the citizens of a given jurisdiction. Each jurisdiction is different in how one of these circumstances creates a relationship between the NPO and the authorities, but one or more of these moments exists in almost every system.³

None of these forms of government engagement or oversight were specifically set up to address issues of terrorist financing. Each of them raises different issues, opportunities, and challenges. The key question is the extent to which a particular form of engagement helps the authorities to gain relevant information about NPOs—concerning finances (especially expenditures), activities, and its management and personnel.⁴

In addition to these forms of government supervision, NPO oversight can take place through self-regulatory organizations (SROs). Although SROs may not have the force of law, they can have the force of contract and the power to sanction their members where there is violation of an agreed code of conduct.⁵ NPO SROs have often been in the front lines of the non-profit sector's fight against fraud, so their forms of oversight may turn out to be more directly relevant for CFT than existing government controls. Governments should recognize the need felt in the sector to demonstrate its good governance and care and its standing as a responsible actor and use that aspiration to also address terrorism financing concerns, allowing it to take ownership of its own problems. Peer pressure and moral suasion can be effective tools to promote a culture of transparency.

Regulation designed to tackle terrorism financing by and through NPOs should be seen as part of a much wider effort to enhance the transparency of the NPO sector—encompassing the governance, finances, and partner organizations—and to strengthen the sector as a whole. Those involved in advising on counter-terrorism financing policy should seek to understand the NPO sector in a country and know what self-regulatory mechanism and government licensing and registration is already in place and make full use of the information already available through those channels. Understanding and knowing the domestic NPO sector and the existing regulations is indispensable before any action is undertaken. Such knowledge and understanding cannot be obtained without the involvement of the sector.

Of course, the above is first and foremost relevant to what we have termed exploited NPOs. Regulation as such is not likely to cause complicit NPOs to change their behavior, although it does provide for the necessary tools to allow early government intervention. The primary agencies responsible for dealing with such organizations however, are the law enforcement or intelligence authorities and not regulatory bodies.

Apply a Risk-Based Approach

When requiring NPOs to take measures specifically to address terrorism financing concerns, governments should recognize the limitations of such obligations. Lack of resources, reliable information, and time may render the fulfillment of those obligations impossible. Depending on how it is done, gathering information on a prospective partner can destroy trust and harm a relationship and the cost, both in terms of time and money, can be considerable. Given their duty towards their donors, it is vital to ensure that those costs are only made when really necessary and in such a way as to promote equality between prospective partners (e.g., by recommending there be an *exchange* of similar information between partners, rather than a one way supply of information from one organization in a developing country to a donor organization in the developed world). To assist NPOs in ensuring their efforts are well directed, governments should conduct risk assessments that clarify what situations are higher risk and when extra efforts may be required. Governments should involve the sector in this effort—only they can provide the information needed to make such an exercise useful.⁶

Be Specific When Discussing NPOs and TF

In order to allow the NPOs to play their vital role, it is important to emphasize that only a very small fraction of the sector has been abused for terrorism financing purposes. Rhetoric associating NPOs and TF in general terms overstates the threat and is not helpful. It risks alienating a vital ally in the struggle against extremism and it renders potential donors reticent to contribute. Rather than making statements about the vulnerability of the NPO sector as such, it would be more productive to concentrate on specific charitable activity that is at risk, erasing the cloud of suspicion hanging over the entire sector and focusing instead

on certain operations. The international community and FATF should remain vigilant and speak out against governments that use the purported connection to justify restricting the space within which civil society can operate.

The Humanitarian Imperative Is Paramount

The civilian population should not be prevented from receiving humanitarian assistance as a result of counterterrorism standards. After all, the ultimate aim of counterterrorism measures is precisely the protection of the civilian population from organized harm; thus, allowing civilians to suffer would constitute an odd confusion between means and ends. Everything should be done to ensure that suffering of victims can be alleviated no matter whose territory they are in.⁷ Indeed, not allowing bona fide NPOs to operate in certain geographical areas would likely expose those in need to terrorist and extremist organizations to a far greater degree. To prevent financial resources from falling into the hands of terrorist related organizations, consideration should be given to aid in kind, and ensuring control up until the final point of distribution.

Notes

¹ Moreover, it is recognized that an important component of any counter-terrorism strategy is gathering intelligence—which is obviously outside the FATF remit—and that the imposition of regulation might yield a useful source of intelligence.

² “The EU’s efforts in the fight against terrorist financing in the context of the Financial Action Task Force’s Nine Special Recommendations and the EU counter terrorist financing strategy, Final Report” (John Howell & Company, February 1, 2007), 33, http://ec.europa.eu/justice_home/doc_centre/terrorism/docs/report_01_02_07_with_appendix_en.pdf. Another EU report on recent measures to improve accountability in the NPO sector found that little evidence FATF or counter-terrorism was a primary factor for reforms in the 140 initiatives identified, See Study on Recent Public and Self-Regulatory Initiatives Improving Transparency and Accountability of Non-Profit Organisations in the European Union, Commissioned by the European Commission Directorate-General of Justice, Freedom and Security Submitted by the European Center for Not-for-Profit Law, April 2009 available online at http://ec.europa.eu/home-affairs/doc_centre/terrorism/docs/initiatives_improving_transparency_accountability_npos_avr09.pdf.

³ It should be clear, however, that there may be NPOs that do not interact with government in any way at all. In the vast majority of cases, this will be because the NPO in question is an informal group of people whose aim is the benefit of the members of the group, or limited in time or whose funds are so insignificant as to make the fulfillment of any formalities not worthwhile. This group is specifically recognized by FATF as of lesser interest in its Best Practice Paper where it states that “Small organisations that do not raise significant amounts of money from public sources, and locally based associations or organisations whose primary function is to redistribute resources among members may not necessarily require enhanced government oversight.”

⁴ In fact, this is recognized by the FATF IN which states: “Specific licensing or registration requirements for counter terrorist financing purposes are not necessary. For example, in some countries, NPOs are already registered with tax authorities and monitored in the context of qualifying for favorable tax treatment (such as tax credits or tax exemptions).”

⁵ For further discussion on the role of self-regulation and the different models of SRO, see Robert Lloyd, “The Role of NGO Self-Regulation in Increasing Stakeholder Accountability” (July 2005), <http://www.oneworldtrust.org/documents/NGO%20Self-Regulation%20July%202005.pdf>. Lloyd discusses under what conditions self-regulation initiatives can increase NGO’s accountability to their beneficiaries.

⁶ For the United States, the American Bar Association has proposed a continuum of risk factors that could be helpful in deciding when to take action, see “Comments in response to Internal Revenue Service Announcement 2—3-29, 2003-20 I.R.B. 928 regarding international grant-making and international activities by domestic 501(c)(3) organizations,” online at <http://www.abanet.org/tax/pubpolicy/2003/030714exo.pdf>.

⁷ See also, Charities Commission, op. cit. p. 7: “It would be profoundly undesirable if an unintended consequence of a counter-terrorist strategy were to make it impossible for legitimate overseas aid charities to be involved in providing aid, or make it impossible for any charity to provide aid in particular parts of the world.”

FATF Special Recommendation VIII

Countries should review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Nonprofit organizations are particularly vulnerable, and countries should ensure that they cannot be misused:

1. by terrorist organizations posing as legitimate entities
2. to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset-freezing measures
3. to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organizations

Interpretative Note to Special Recommendation VIII: Nonprofit Organizations

Introduction

1. Nonprofit organizations (NPOs) play a vital role in the world economy and in many national economies and social systems. Their efforts complement the activity of the governmental and business sectors in providing essential services, comfort, and hope to those in need around the world. The ongoing international campaign against terrorist financing has, unfortunately, demonstrated that terrorists and terrorist organizations exploit the NPO sector to raise and move funds, provide logistical support, encourage terrorist recruitment, or otherwise support terrorist organizations and operations. This misuse not only facilitates terrorist activity but also undermines donor confidence and jeopardizes the very integrity of NPOs. Therefore, protecting the NPO sector from terrorist abuse is both a critical component of the global fight against terrorism and a necessary step to preserve the integrity of NPOs.
2. NPOs may be vulnerable to abuse by terrorists for a variety of reasons. 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. Depending on the legal form of the NPO and the country, NPOs may often be subject to little or no governmental oversight (e.g., registration, record keeping, reporting, and monitoring), or few formalities may be required for their creation (e.g., there may be no skills or starting capital required and no background checks necessary for employees). Terrorist organizations have taken advantage of these characteristics of NPOs to infiltrate the sector and misuse NPO funds and operations to cover for or support terrorist activity.

Objectives and General Principles

3. The objective of Special Recommendation VIII (SR VIII) is to ensure that NPOs are not misused by terrorist organizations: (i) to pose as legitimate entities; (ii) to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; or (iii) to conceal or obscure the

clandestine diversion of funds intended for legitimate purposes but diverted for terrorist purposes. In this Interpretative Note, the approach taken to achieve this objective is based on the following general principles:

- a. Past and ongoing abuse of the NPO sector by terrorists and terrorist organizations requires countries to adopt measures both:
 - (i) protect the sector against such abuse and identify and,
 - (ii) take effective action against those NPOs that either are exploited by or actively support terrorists or terrorist organizations.
- b. Measures adopted by countries to protect the NPO sector from terrorist abuse should not disrupt or discourage legitimate charitable activities. Rather, such measures should promote transparency and engender greater confidence in the sector, across the donor community and with the general public, that charitable funds and services reach intended legitimate beneficiaries. Systems that promote achieving a high degree of transparency, integrity, and public confidence in the management and functioning of all NPOs are integral to ensuring the sector cannot be misused for terrorist financing.
- c. Measures adopted by countries to identify and take effective action against NPOs that either are exploited by or actively support terrorists or terrorist organizations should aim to prevent and prosecute, as appropriate, terrorist financing and other forms of terrorist support. Where NPOs suspected of or implicated in terrorist financing or other forms of terrorist support are identified, the first priority of countries must be to investigate and halt such terrorist financing or support. Actions taken for this purpose should, to the extent reasonably possible, avoid any negative impact on innocent and legitimate beneficiaries of charitable activity. However, this interest cannot excuse the need to undertake immediate and effective actions to advance the immediate interest of halting terrorist financing or other forms of terrorist support provided by NPOs.
- d. Developing cooperative relationships among the public, private, and NPO sector is critical to raising awareness and fostering capabilities to combat terrorist abuse within the sector. Countries should encourage the development of academic research on, and information sharing in, the NPO sector to address terrorist financing related issues.
- e. A targeted approach in dealing with the terrorist threat to the NPO sector is essential given the diversity within individual national sectors, the differing degrees to which parts of each sector may be vulnerable to misuse by terrorists, the need to ensure that legitimate charitable activity continues to flourish, and the limited resources and authorities available to combat terrorist financing in each jurisdiction.
- f. Flexibility in developing a national response to terrorist financing in the NPO sector is also essential in order to allow it to evolve over time as it faces the changing nature of the terrorist financing threat.

Definitions

4. For the purposes of SR VIII and this Interpretative Note, the following definitions apply:
 - a. The term *nonprofit organization*, or *NPO*, refers to a legal entity or organization that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social, or fraternal purposes, or for the carrying out of other types of “good works.”

- b. The terms *FIU*, *legal arrangement*, and *legal person* are as defined by the FATF Forty Recommendations (2003) (the FATF Recommendations).
- c. The term *funds* is as defined by the Interpretative Note to FATF Special Recommendation II.
- d. The terms *freezing*, *terrorist*, and *terrorist organization* are as defined by the Interpretative Note to FATF Special Recommendation III.
- e. The term *appropriate authorities* refers to competent authorities, self-regulatory bodies, accrediting institutions, and other administrative authorities.
- f. The term *beneficiaries* refers to those natural persons, or groups of natural persons who receive charitable, humanitarian or other types of assistance through the services of the NPO.

Measures

- 5. Countries should undertake domestic reviews of their NPO sector or have the capacity to obtain timely information on its activities, size, and other relevant features. In undertaking these assessments, countries should use all available sources of information in order to identify features and types of NPOs, which, by virtue of their activities or characteristics, are at risk of being misused for terrorist financing.¹ Countries should also periodically reassess the sector by reviewing new information on the sector's potential vulnerabilities to terrorist activities.
- 6. There is a diverse range of approaches in identifying, preventing, and combating terrorist misuse of NPOs. An effective approach, however, is one that involves all four of the following elements: (a) outreach to the sector, (b) supervision or monitoring, (c) effective investigation and information gathering, and (d) effective mechanisms for international co-operation. The following measures represent specific actions that countries should take with respect to each of these elements in order to protect their NPO sector from terrorist financing abuse.
 - a. Outreach to the NPO sector concerning terrorist financing issues
 - (i) Countries should have clear policies to promote transparency, integrity, and public confidence in the administration and management of all NPOs.
 - (ii) Countries should encourage or undertake outreach program to raise awareness in the NPO sector about the vulnerabilities of NPOs to terrorist abuse and terrorist financing risks, and the measures that NPOs can take to protect themselves against such abuse.
 - (iii) Countries should work with the NPO sector to develop and refine the best practices to address terrorist financing risks and vulnerabilities and, thus, protect the sector from terrorist abuse.²
 - (iv) Countries should encourage NPOs to conduct transactions via regulated financial channels, wherever feasible, keeping in mind the varying capacities of financial sectors in different countries and in different areas of urgent charitable and humanitarian concerns.
 - b. Supervision or monitoring of the NPO sector

Countries should take steps to promote effective supervision or monitoring of their NPO sector. In practice, countries should be able to demonstrate that the following standards apply to NPOs that account for (1) a significant portion of the financial resources under control of the sector; and (2) a substantial share of the sector's international activities.

 - (i) NPOs should maintain information on: (1) the purpose and objectives of their stated activities; and (2) the identity of the person(s) who own, control, or direct their activities, including senior officers, board

- members, and trustees. This information should be publicly available, either directly from the NPO or through appropriate authorities.
- (ii) NPOs should issue annual financial statements that provide detailed breakdowns of incomes and expenditures.
 - (iii) NPOs should be licensed or registered. This information should be available to competent authorities.³
 - (iv) NPOs should have appropriate controls in place to ensure that all funds are fully accounted for and are spent in a manner that is consistent with the purpose and objectives of the NPO's stated activities.
 - (v) NPOs should follow a "know your beneficiaries and associate NPOs" rule,⁴ which means that the NPO should make best efforts to confirm the identity, credentials, and good standing of their beneficiaries and associate NPOs. NPOs should also undertake best efforts to document the identity of their significant donors and to respect donor confidentiality.
 - (vi) NPOs should maintain, for a period of at least five years, and make available to appropriate authorities, records of domestic and international transactions that are sufficiently detailed to verify that funds have been spent in a manner consistent with the purpose and objectives of the organization. This also applies to information mentioned in paragraphs (i) and (ii) above.
 - (vii) Appropriate authorities should monitor the compliance of NPOs with applicable rules and regulations.⁵ Appropriate authorities should be able to properly sanction relevant violations by NPOs or persons acting on behalf of those NPOs.⁶
- c. Effective information gathering and investigation
- (i) Countries should ensure effective cooperation, coordination, and information sharing to the extent possible among all levels of appropriate authorities or organizations that hold relevant information on NPOs.
 - (ii) Countries should have investigative expertise and capability to examine those NPOs suspected of either being exploited by or actively supporting terrorist activity or terrorist organizations.
 - (iii) Countries should ensure that full access to information on the administration and management of a particular NPO (including financial and programmatic information) may be obtained during the course of an investigation.
 - (iv) Countries should establish appropriate mechanisms to ensure information is promptly shared with all relevant competent authorities in order to take preventative or investigative action when there is suspicion or reasonable grounds to suspect that a particular NPO: (1) is a front for fundraising by a terrorist organization; (2) is being exploited as a conduit for terrorist financing, including for the purpose of escaping asset freezing measures; or (3) is concealing or obscuring the clandestine diversion of funds intended for legitimate purposes, but redirected for the benefit of terrorists or terrorist organizations.
- d. Effective capacity to respond to international requests for information about an NPO of concern

Consistent with Special Recommendation V, countries should identify appropriate points of contact and procedures to respond to international requests for information regarding particular NPOs suspected of terrorist financing or other forms of terrorist support.

Notes

¹ For example, such information could be provided by regulators, tax authorities, FIUs, donor organizations, or law enforcement and intelligence authorities.

² The FATF's *Combating the Abuse of Non-Profit Organisations: International Best Practices* provides a useful reference document for such exercises.

³ Specific licensing or registration requirements for counterterrorist financing purposes are not necessary. For example, in some countries, NPOs are already registered with tax authorities and monitored in the context of qualifying for favorable tax treatment (such as tax credits or tax exemptions).

⁴ The term "associate NPOs" includes foreign branches of international NPOs.

⁵ In this context, rules and regulations may include rules and standards applied by self-regulatory bodies and accrediting institutions.

⁶ The range of such sanctions might include freezing of accounts, removal of trustees, fines, de-certification, de-licensing, and de-registration. This should not preclude parallel civil, administrative, or criminal proceedings with respect to NPOs or persons acting on their behalf when appropriate.

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One of the ways in which terrorist organizations raise and transfer funds is by using nonprofit organizations (NPOs); however NPOs are also an important way to deal with the conditions conducive to the spread of terrorism. In trying to address one problem—terrorism financing—it is important not to diminish the important work of NPOs. This paper discusses the threat and how to address it without tainting the entire NPO sector and concludes that it is inefficient and counterproductive to devise an entirely new regulatory framework. The ultimate objective is to enhance the transparency of the NPO sector—the people in charge of NPOs, NPO funding sources, and how funds are spent. The NPO sector has a stake in being clean and being regarded as such by others, thus NPOs are indispensable partners in drawing up regulatory policies, including self-regulatory policies.

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