Nonprofit Organizations — Overview

Objective. *Assess the adequacy of the bank's systems to manage risks associated with accounts of nonprofit organizations, and management's ability to implement effective due diligence, monitoring, and reporting systems based on a risk-based approach.*

Nonprofit organizations (NPOs) are entities (legal persons, arrangements or organizations) that engage 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."[1] NPOs may provide basic social services, work to relieve suffering, promote the interests of the poor, bring citizen concerns to governments, encourage political participation, protect the environment, or undertake community development to serve the needs of citizens, organizations, or groups in the communities in which they operate.

The U.S. NPO sector is extremely diverse, ranging from large regional, national or international charities to small, community-based organizations offering a wide variety of programs and services. Research institutes, churches, professional associations, and lobby groups, are among the many types of NPOs that typically depend, in whole or in part, on donations, dues or voluntary service for support. The IRS recognizes more than two dozen types of NPOs, with charities[2] making up the largest category of exempt organizations.

NPOs are subject to a complex system of regulation and oversight at the federal, state and local levels. The IRS and state authorities require registration, reporting, and monitoring of most NPOs.[3] Many NPOs also adhere to voluntary self-regulatory standards and controls to improve individual governance, management and operational practice, in addition to internal controls required by donors and others.[4] These regimes primarily regulate raising, spending and accounting for funds, seek to protect the public from fraud, and encourage charitable giving. NPOs receiving federal grants undergo additional review by grant making agencies to comply with standards required by OMB (e.g. Agency for International Development [AID] recipients are subject to rigorous scrutiny, compliance, and independent auditing requirements).

The US and FATF support a risk-based approach to the implementation of AML/CFT financial controls, noting the importance of financial institutions understanding the terrorist financing risks to which they are exposed and taking appropriate risk mitigation measures to address them.[5] Both also recognize that not all NPOs are at risk. While FATF initially characterized NPOs generally as being "particularly vulnerable" to terrorist abuse, the threat environment has evolved and it now recognizes that only a small fraction are at risk and recommends a risk-based approach to manage those risks.[6] The risk-based approach is not intended to discourage

---

[1] FATF Recommendation 8

[2] The IRS defines a charity as a group whose purpose is "relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency."

[3] Churches automatically qualify for federal income tax exemption under rule 501(c) (3) and therefore are not regulated by the IRS; as part of its regulation of tax-exempt charitable organizations and private foundations, the IRS requires the annual filing of forms and disclosures; for public charities, IRS Form 990 Schedule F provides extensive financial and other details on NPOs' missions, programs, donors and operations, etc. outside the US. NPOs generally must file information to state regulatory authorities where they incorporate. See "Regulation of Nonprofit Organizations in the U.S. – An Overview" at http://www.acams.org/aml-resources/npos/.

[4] See overview of NPO self-regulatory initiatives to ensure accountability and transparency at http://www.acams.org/aml-resources/npos/. These include BBB Wise Giving Alliance, Global Giving, and TechSoupGlobal, in addition to NPO due diligence initiatives to protect the organization, its donors, programs, partners and recipients and prevent abuse by terrorists and criminals (e.g. Principles of International Charity, Sphere Project, and InterAction Private Voluntary Organization Standards.

[5] Joint letter from Departments of Treasury and State to the Charity & Security Network, May 13, 2016

[6] See FATF documents, guidance, in particular, the revised Interpretive Note to Recommendation 8, *Best Practices in Combatting the Abuse of Nonprofit Organizations (Recommendation 8)*, and *Guidance for a Risk-Based Approach*.

banks from providing services to NPOs found to be higher risk, but rather to focus risk mitigation and management measures on areas of vulnerability so as to minimize risk.

Banking Services to NPOs

The charitable sector provides essential services, complementing government initiatives to assist those in need, often in high risk areas, conflict zones, and inaccessible regions. NPOs' charitable activities help to meet vital humanitarian and development needs, and to carry out their missions, NPOs need access to financial services. The U.S. Government recognizes and strongly supports the essential role of charity in communities worldwide, and views provision of financial services to NPOs to be in the public interest and consistent with AML/CFT goals.[7] Many NPOs play a crucial part in fighting conditions conducive to terrorism, reducing the appeal of terrorism by building social structures and increasing intercommunity dialogue and understanding.[8] Inadequate financial access and/or delayed transactions due to concerns for regulatory risk can undermine AML/CFT objectives by driving financial transactions outside of regulated channels, and should be avoided when possible.[9] Protecting the charitable sector from terrorist abuse using a risk-based approach and promoting access to financial services are complementary goals.

Regulatory Expectations

Banks are expected to apply their due diligence obligations reasonably, but not be infallible in doing so.[10] "Government has not advocated a standard of perfection, as such would inhibit financial access promoting neither efficiency nor transparency. Instead banks should establish and maintain appropriate risk-based AML/CFT controls and compliance programs which will enable them to appropriately manage their accounts, detect illicit, transactions, and avoid enforcement actions."[11]

Although NPOs maintain operating accounts at banks, the BSA does not require, and neither do FinCEN nor the federal banking agencies expect, banks to serve as the *de facto* regulator of individual NPO customers. While banks are expected to manage AML and OFAC risk associated with all accounts, including NPO accounts, banks will not be held directly responsible for their customers' compliance with OFAC sanctions or other applicable federal and state laws and regulations.

Assessing Risk

While the extent of the terrorist financing risk for charitable organizations varies dramatically depending on the operations and activities of the NPO, "the vast majority pose little or no terrorist financing risk."[12] Some organizations, particularly those based or operating in higher-risk jurisdictions may be at greater risk of terrorist abuse but vulnerability depends on the specific activities of the NPO, rather than on the simple fact that it is operating on a non-profit basis. Banks should assess risk associated with the NPO itself, in the context of the relationship with the bank, in order to determine the appropriate inherent and/or residual AML/CFT risk.

---

[7] Jennifer Fowler, "Treasury Efforts to Protect and Support the Charitable Sector," Treasury Blog, 28 April 2016.
[8] UN Counter-Terrorism Implementation Task Force Report, "Tackling the Financing of Terrorism"
[9] Comments by Treasury Secretary Jack Lew, World Bank Annual Meetings, 7 October 2016; FATF, *Risk of terrorist abuse in non-profit organisations*, June 2014
[10] Treasury Blog, 28 April 2016.
[11] Remarks By Acting Under Secretary Adam Szubin At The ABA/ABA Money Laundering Enforcement Conference, 16 November 2015.
[12] The National Terrorist Financing Risk Assessment (2015) noted that terrorist organizations may abuse the NPO sector by moving their funds through legitimate NPOs, often without knowledge of donors, management or staff, or may even create sham NPOs to funnel money to fund terrorism related activities.

The following factors, which are not unique to NPOs, may be useful in helping to identify and evaluate relative risk:

- Geographic location, including headquarters, operational areas, and geographic areas served by the NPO, or proximity to terrorist threat[13];
- Significant influence or prominent involvement in the NPO of politically exposed persons (PEPs) or other higher-risk persons;
- NPO funding sources and intended use of funds;
- Bank products and services utilized by NPO.

NPO Risk Mitigation

A bank's policies, procedures, and processes should provide for sound due diligence and verification practices, adequate risk assessment of NPO accounts, and ongoing monitoring and reporting of unusual or suspicious activities. A bank that establishes and maintains accounts for NPOs should apply appropriate, specific, risk-based and where necessary, EDD policies, procedures, and controls.
Examples of factors that may reduce or mitigate risk include:

- NPOs carrying out programs on behalf of, or funded by, U.S. Government agencies or programs, that meet rigorous AID criteria;
- NPOs participation in voluntary standard and self-regulatory programs to ensure accountability and transparency[14];
- Demonstration of effective internal controls and due diligence standards to assess and manage risk and screen beneficiaries in higher risk areas;
- Specific activities of NPOs, with expressive organizations (e.g. those engaging in sports and recreation, arts and culture, interest representation and advocacy) being less vulnerable than service NPOs (e.g. those providing housing, social services, education and health care).[15]

Due Diligence Expectations

Due diligence measures by financial institutions should be commensurate with the level of risk of the NPO. Accordingly, if a bank's assessment of a particular NPO indicates a lower risk of illicit activity, a bank is not expected to perform further due diligence beyond minimum expectations. However, if the potential for heightened risks of money laundering or terrorist financing exists, the bank should conduct further due diligence to determine that the NPO has processes and mechanisms in place to deal with risk. Banks are not required to assess the adequacy of NPO internal control procedures, and there is no requirement for banks to conduct due diligence on the customers of NPO clients.[16]

In addition to obtaining required CIP information, additional levels of due diligence for NPOs should, subject to the risk-based approach, focus on aspects of the organization that can increase a bank's confidence in conducting business with the client. The FATF expressly acknowledges that it is important that measures taken to protect the charitable sector do not disrupt or discourage legitimate charitable activities, and should not

---

[13] Charities operating in proximity to an active terrorist threat are generally considered at greater risk. According to the 2014 FATF report, "evidence shows that the incidence of terrorist abuse of NPOs is low;" the "key variable of risk is not geographic, but the proximity to an active threat…Ultimately, the principal considerations for determining which NPOs are at a higher risk of abuse are the value of their resources or activities to terrorist entities, and the proximity to an active terrorist threat that has the capability and intent to abuse NPOs."
[14] See footnote 4. Guidestar makes available IRS Form 990 and Schedule F filings required of all charitable organizations (and is considering assigning badges based on the amount of information an NPO provides). Others such as the Foundation Center and Global Giving offer online platforms tracking donor funds and providing assurances to donors.
[15] 2014 FATF report
[16] U.S. Department of the Treasury and Federal Banking Agencies Joint Fact Sheet on Foreign Correspondent Banking: Approach to BSA/AML and OFAC Sanctions Supervision and Enforcement, 30 August 2016.

unduly or inadvertently restrict NPO's ability to access resources, including financial resources, to carry out their legitimate activities. Appropriate due diligence may include, depending on the level of risk, a review of the following*:*

- Purpose and nature of NPO, including mission(s), stated objectives, programs, activities, and services;
- Organizational structure, including key principles, management and internal controls of NPO;
- Operational locations, particularly in higher-risk areas where terrorist groups are most active;
- State incorporation, registration and tax-exempt status by the IRS and of required reports with regulatory authorities;
- Voluntary participation in self-regulatory programs to enhance governance, management, and operational practice;
- Documents that articulate internal controls to prevent diversion of resources, results of self-governing evaluations;
- Review of available financial statements and audits;
- General information about funding and criteria for disbursement of funds, including guidelines/standards for qualifying beneficiaries;
- General information about the donor base, and for public charities, level of support from the general public (as defined by the IRS test)[17]
- Financial and program management processes and controls;
- Possible site visits for higher risk NPOs.

Expectations for Ongoing Controls

Banks should be evaluated on their overall program to manage the risk of NPOs, and should ensure that their control infrastructure is appropriately based on the aggregate risk of the portfolio. Generally NPOs are subject to controls that apply to all clients (such as transaction monitoring, client and transaction OFAC screening, etc.) and do not require the creation of specialized monitoring controls specific to NPOs. As it relates to monitoring for suspicious activity, banks are not expected to positively affirm the legitimacy of every transaction conducted by an NPO, but instead banks should ensure that overall processes to conduct transaction monitoring to identify and report suspicious activity, including NPO accounts, is sound. Provided that banks have a reasonable process for understanding the level of risk and commensurate due diligence, decisions to maintain NPO accounts are not considered unduly risky or to be second-guessed, and the program/controls should be viewed as sufficient.

[17] NPOs are required to protect the privacy of their donors, as a matter of good governance and various legal requirements. Although some donor information is included on Form 990, the IRS does not permit publication of donor details but retains such information for enforcement purposes. "Banks are not expected to know the identity of each individual donor for most charities; however, they are expected to conduct enhanced due diligence for accounts the bank considers high risk, to include evaluating large contributors or grantors in those instances." Joint Letter, 13 May 2016.