

ESG and AML professionals must urgently join forces

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The 2022 Intergovernmental Panel on Climate Change (IPCC) report states that “Human-induced climate change has caused widespread adverse impacts ... Near-term actions ... would substantially reduce projected losses and damages”.⁽ⁱ⁾ A commonly overlooked subject that heightens these losses and damages is environmental crime, and the laundering of its proceeds through legitimate financial institutions.

Old problem, new challenge

In its July 2021 *Money Laundering from Environmental Crime* report, the Financial Action Task Force (FATF)⁽ⁱⁱ⁾ defines environmental crime as any criminal offense harming the environment, such as illegal logging, land clearance and mining; wildlife threats; the illegal exploitation or trade of fishery and forestry; and waste trafficking. The report states that “the ‘low risk, high reward’ nature of environmental crime makes for a lucrative and safe source of revenue for criminals”, as it includes high-value positive products like diamonds, minerals and timber and also high-value negative products like waste, such as plastics or electronics (e-waste), making it a multi-billion-dollar concern.

According to a joint United Nations Environment Programme (UNEP) and International Criminal Police Organization (Interpol) report, environmental crime is estimated to generate more than USD255 billion a year and “is aimed at benefitting individuals or groups or companies from the exploitation of, damage to, trade or theft of natural resources, including, but not limited to serious crimes and transnational organized crime”.⁽ⁱⁱⁱ⁾

It is both a regulatory obligation and a societal responsibility for all financial players to not only detect environmental crime, but also to sharpen and reinforce their preventive measures.

As environmental resources are limited, several Luxembourgish regulations condemn willful blindness to or damaging acts that negatively affect the environment:

- Article 506-1 of the Luxembourg penal code;
- Article 1 of the Law of 12 November 2004 as amended to fight against money laundering and terrorist financing;
- Article 64 of the Law of 19 January 2004 as amended to protect nature and natural resources;
- Article 9 of the Law of 21 June 1976 as amended on the fight against atmospheric pollution;



- Article 26 of the Law of 29 July 1993 concerning the protection and management of water;
- Article 35 of the Law of 17 June 1994 on the prevention and management of waste; and
- The National Risk Assessment of Money Laundering and Terrorist Financing of 15 September 2020.

At a supranational level, the third FATF recommendation^(iv) and the sixth Anti-Money Laundering (AML) Directive (6AMLD)^(v), soon to be implemented in Luxembourg, criminalize the money laundering of environmental violations. These unequivocally tie environmental crime to money laundering, creating a more coercive regulatory framework.

Humankind has a collective responsibility to effectively address and manage this challenge, and tangible and bold actions are required. Greenwashing, or merely stating that a company embraces a relevant environmental policy, is no longer enough.

What can be done?

To create measures and controls that mitigate the risk of environmental money laundering or terrorist financing (ML/TF), financial institutions can follow these pragmatic steps:

1. Formalize a solid commitment from the top management level, and include a clear definition in your risk appetite statement (RAS) about environmental crime.
2. Include environmental crime as a factor in your risk-based approach (RBA), showing clear evidence of the identified potential high risks of ML/TF environmental crime and the strategies developed to mitigate them. These should cover all factors, including customers, geographical areas, products and services, and delivery channels. An in-depth and wide analysis is required because of the global nature of traded goods and their handling. As most processes can be outsourced to third parties, care must be taken so that no risk area is overlooked.



For example, according to the Commission de Surveillance du Secteur Financier (CSSF) communication released on 16 August 2022, financial institutions should measure whether a new or existing product that is or will be financed, developed, or insured has or will cause material damage to the environment and natural resources.^(vi)

Regarding geographic risk, alongside the customer’s jurisdictions, representatives and beneficial owners, the customer’s downstream networks should also be considered—notably the jurisdictions of their source, transit (and bordering countries) and destination—to ensure these are not environmental crime hotspots.

These should be taken into account when calculating a client’s ML/FT risk to ensure that:

- Funds entering an organization; and
- Customer’s business activities; are not tied to environmental crime, either directly or indirectly.

3. Extend your know-your-customer (KYC) data to include environmental, social, and governance (ESG) key performance indicators (KPIs). This data can be further supplemented by including specific questions on the extent of a customer’s environmental footprint (its care or delinquency) in the client due diligence questionnaire (DDQ) by:
 - a. Performing the DDQ through both a client self-declaration and an “internal” questionnaire that is initially filled out by the first line of defense (1LoD), then by the second line of defense (2LoD); and
 - b. Comparing to targets defined as acceptable in Risk Appetite Statement per customer type, and assess and monitor these throughout the relationship.

An institution with incomplete KYC information and not monitoring the ongoing business relationship could unintentionally be an accomplice to environmental crime. Your ML/TF risk may increase if the client or subcontractor is delinquent in its environmental agreements or responsibilities.

4. Apply an enhanced due diligence (EDD) model when a customer is directly or indirectly involved in the treatment/trade of natural resources (illustrative list):
 - a. For functions outsourced by a company, including in the same group, request supporting documentation from its customers and counterparties and/or obtain the necessary documentation from reliable sources to confirm the responsible delegate or subcontractor’s capability to manage the treatment of goods. For example, regarding e-waste treatment, institutions should determine whether the client or its subcontractor has all the technical and human capital capabilities and experience to recycle this e-waste.
 - b. Obtain valid copies of exploitation, trade, or transportation licenses.
 - c. Where necessary, use reliable, publicly searchable and satellite data to ensure the source of funds and wealth does not originate from factories or refineries in environmental crime hotspots.
 - d. Verify a customer’s production overhead, expense and variance accounts and ensure the KPIs related to waste are being met. Any inconsistencies should be followed-up. If management has not demonstrated suitable waste mitigation actions, this can be a red flag for illicit waste trafficking.^(vii) Since EDD requires the analysis of financial statements, the 1LoD must also verify this information with the ESG officer’s support, which is then reviewed by the 2LoD, until sufficient comfort is obtained or not.
 - e. Obtain and analyze transporters’ trade routes for clients involved in goods export, import and transportation. Data discrepancies can be a red flag of the illicit trade of natural resources.

5. Apply the EDD model to complex structures. While the illegal dumping of waste is rare in the West, financial institutions should still exercise vigilance, as criminal masterminds may hide their environmental criminal activity in a complex global legal structure or related party. Illegal goods and services may be intermingled with legal ones. Similarly, offshore-related parties or companies may be used to front or hide unanticipated production overheads, variances or waste.

EDD is critical to this point because:

- Environment crime is intertwined with other ML mechanisms, e.g., fraudulent and corrupt practices, terrorist financing, and illegal tax schemes, to name a few; and
- Criminals use opaque structures across several jurisdictions, including non-cooperative countries. Companies in these jurisdictions can benefit from regulatory differences or weaker AML infrastructures and controls.

6. Perform analytical review procedures on transactions to identify movements that contradict the customer recorded profile, as they may be related to environmental violations.

The 2021 FATF report further states:

- “Consultations and geological data sug-

gest that ... precious metals, stones and timber ... are distributed broadly to destination markets in Asia, Europe, and North America.”

- “Illegally logged wood is also transported ... to destinations in East Asia, North America and Western Europe.”
- “With the exception of waste trafficking, environmental crimes generally occur in resource-rich developing and middle-income countries, with proceeds coming from larger, developed economies.”^(viii)

Globalization allows companies to tap into markets across their borders, with goods and finances easily moved across the globe in an activity that generates more than USD255 billion a year.

7. Target corruption indicia and scrutinize relationships involving politically exposed persons (PEP) and their close associates. These large and global transactions require “vehicles” fabricated through the practices of connected networks: “corruptees” require “corruptors”, and both are equally to blame.

8. Use anti-environment crime agencies when screening customers and their affiliations to assess their potential involvement in environmental violations.

9. Redesign employee training to include the detection of environmental crime schemes.

10. Consider filing suspicious activity reports (SARs) to financial intelligence units (FIUs) when environmental crime is suspected.

In today’s times, when wars start in the blink of an eye and crises spread globally at lightning speed, our ability to fight environmental crime is one of humankind’s greatest challenges. We must realize that no Earth B exists; the clock is ticking, so we need to act now to strengthen our resolve and vigilance.

i) Intergovernmental Panel on Climate Change, *Climate Change 2022: Impacts, Adaptation and Vulnerability*, 27 February 2022.
ii) The Financial Action Task Force, *Money Laundering from Environmental Crime*, July 2021.
iii) UNEP and Interpol, *The rise of Environmental Crime, A Growing Threat to Natural Resources, Peace, Development and Security*, 2016.
iv) Financial Action Task Force, *The FATF Recommendations: International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation*, updated March 2022, pp. 121, 139.
v) Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law.
vi) Benoît Theunissen, “Les aspects ESG vont au-delà de la compliance financière”, *Paperjam*, August 16, 2022.
vii) Lawyer Chukwuma Obara, John Ohaka, Efelelo Nangih and Ifeanyi Chukwu Ogaluzor Odinakachukwu, “The Effect of Accounting For Waste Management Expenditure On the Profitability of Oil and Gas Companies in Nigeria”, *International Journal of Economics, Commerce and Management V*, No. 3 (2017).
Basel Institute On Governance, *Illegal waste trade: what’s driving this multi-billion dollar transnational crime and what could stop it?*, July 16, 2021.
viii) The Financial Action Task Force, *Money Laundering from Environmental Crime*, July 2021.