ENHANCED LIABILITY

Breaking the Environmental Crimes-Finance Connection

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FINANCE FOR BIODIVERSITY Initiative

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About this publication

This report presents Finance for Biodiversity's (F4B) analysis and recommendations on how to break the connection between environmental crimes and finance. It has been prepared as an invited contribution to the UK Government-sponsored Global Resource Initiative (GRI), a multi-sectoral taskforce assigned to provide recommendations on greening the UK's international supply chain footprint.

This paper's primary focus is the potential for extending the use and positive impact of Anti-Money Laundering (AML) rules in reducing environmental crimes. In exploring this potential and its limitations, however, the report highlights the need to go beyond the broader application of AML in breaking the current connection between legitimate financing and environmental crimes. The report proposes a way forward, encouraging the financial community to take leadership in advancing voluntary measures paralleling anti-slavery and conflict diamond approaches.

Comments are welcomed to **Simon Zadek** at **simon.zadek@f4b-initiative.net**.

This work is part of F4B's wider programme on advancing liabilities-based approaches to increasing the materiality of biodiversity in financial decision-making.

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About FINANCE FOR BIODIVERSITY Initiative

F4B's goal is to increase the materiality of biodiversity in financial decision-making, and so better align global finance with environmental conservation and restoration.

Our work on liabilities draws from the entirety of our portfolio, which is organised across five workstreams:

- **Market efficiency and innovation:** including a leadership role in the Taskforce on Nature-related Financial Disclosures (TNFD), and support to several data- and fintech-linked initiatives.
- **Enhanced liability:** extending the legal liabilities of financial institutions for biodiversity outcomes, including innovations such as legal personhood for nature.
- **Citizen engagement:** public advocacy, campaigning and advancing digital approaches to catalysing shifts in citizens' financing behaviour.
- **Public finance:** advancing measures and advocacy linked to stimulus and recovery spending, and the place of nature in sovereign debt markets.
- **Nature markets:** catalysing nature markets by developing new revenue streams and robust governance innovations.

F4B has been established with support from the MAVA Foundation, which has a mission to conserve biodiversity for the benefit of people and nature. F4B's work benefits from partnership with, and support from, the Children's Investment Fund Foundation (CIFF) and the Gordon and Betty Moore Foundation through The Finance Hub.

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This report has been prepared as a contribution to the UK Government-sponsored Global Resource Initiative (GRI) taskforce to support its consideration of recommendations that support the UK lightening its environmental footprint across international supply chains.

The views represented in this document are solely those of the Finance for Biodiversity Initiative, although it has benefited from inputs from GRI members.

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Summary

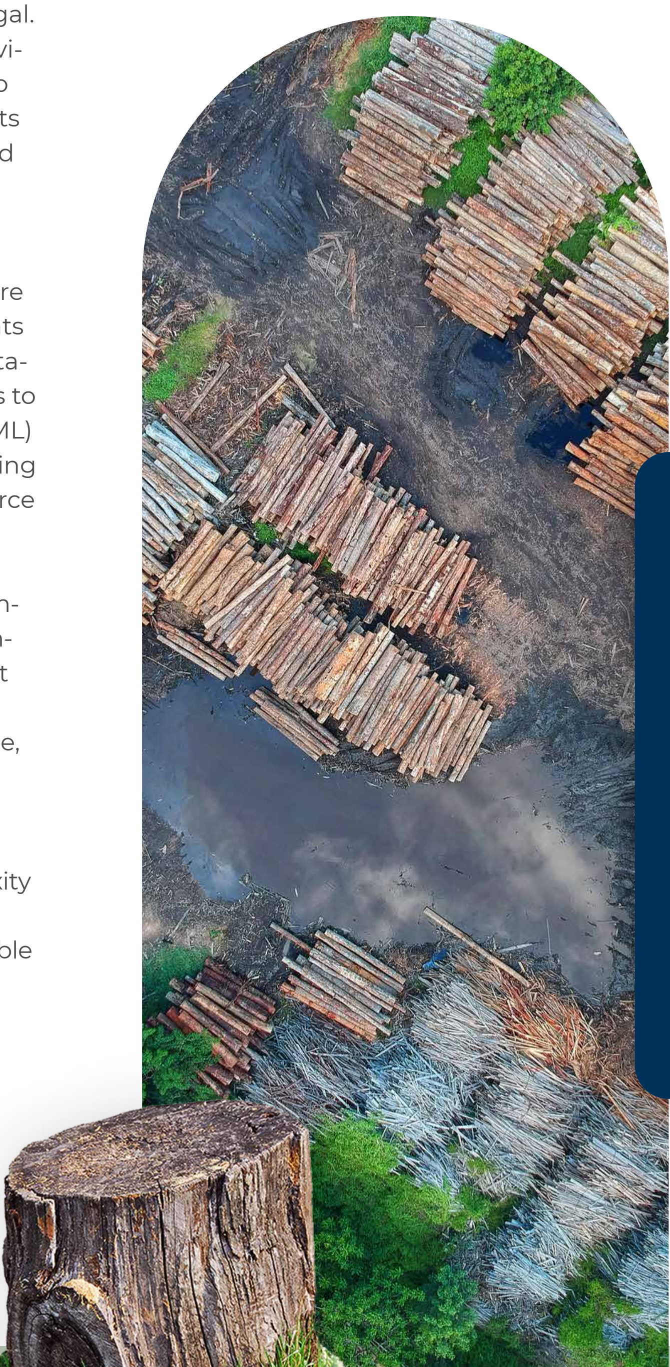
Environmental crime is in the top five most profitable global criminal enterprises, generating up to almost US$300 billion annually. Associated tax revenue losses amount to nearly US$30 billion per annum, notably in poorer, environmentally-rich countries.

Yet it is damage to the environment itself that results in more profound, extensive, and often permanent costs to societies. More than two-thirds of tropical deforestation to make way for agricultural production, for example, is illegal. Such illegal destruction through criminal activities reduces the environment's contribution to economic prosperity and livelihoods, undercuts the resilience of communities and nations, and diminishes the environment's contribution to addressing climate change.

Efforts to reduce environmental destruction are ramping up, including high-level commitments made at COP26 in Glasgow to reduce deforestation to zero by 2030. There are renewed efforts to make wider use of anti-money laundering (AML) rules in reducing environmental crimes, building on the breakthrough Financial Action Task Force (FATF) report on environmental crime.

Many financial institutions are increasingly committed to addressing the occurrence of environmental crime in their financial value chains, not least because of the associated compliance requirements and penalties for non-compliance, and growing reputational and litigation risks. Concerns are raised by the industry, however, as to the practical challenges in turning such commitments into practice, given the complexity of transactions and supply chains. That said, digitally-powered innovations increasingly enable even the most complex traceability challenges to be overcome, especially if linked to suitable incentives and channels for stakeholder voices.

Breaking the Environmental Crimes-Finance Connection is grounded in Finance for Biodiversity's fundamental position that our collective aim must be to ensure the entire value chain of legal financing should be free of environmental crimes. Notably, there is a need to ensure there is no beneficial relationship accruing to financial institutions from ecosystem services linked to environmental crimes.



In exploring how best to catalyse major progress towards achieving this aim, the report explores three practical fronts:

- How best to extend the application of AML regulations to a wide range of environmental crimes.
- How best to broaden the basis on which AML-linked culpability would arise, notably to address the critical issue of how to end beneficiary relationships between legal financiers and environmental crimes.
- Whether, and if so how, to move beyond AML regulations in establishing a due diligence framework to ensure that financing value chains are free of environmental crimes.

Progress across these three fronts would make a significant difference in alerting the financial community to the presence of environmental crimes in their financing value chains, and encouraging more rapid, robust and remedial action. Such progress would be further amplified and accelerated by being associated with a raft of new environmental-focused developments, from new due diligence obligations (DDOs) on deforestation, to mandatory public reporting on environmental impact, and to improve nature-related risk management through initiatives such as the Taskforce on Nature-related Financial Disclosures (TNFD).

In this context, although developed with an initial UK perspective, our analysis and recommendations are internationally relevant across many financial centres and jurisdictions, including environmentally-intensive countries.

Breaking the Environmental Crimes-Finance Connection concludes that there is major potential to make significant progress towards the goal of an environmental crime-free financing value chain through the combined effects of:

- More intensively and resolutely applying existing AML rules.
- Strengthening the environmental-related capacities of existing financial regulators.
- Encouraging the financial community to develop and adopt new due diligence frameworks and data sources.

By advancing ambitiously on these fronts, environmental crimes can be significantly reduced, mitigating the threat to financial institutions of reputational damage and litigation, and obviating the need for new, onerous regulations.

Breaking the Environmental Crimes-Finance Connection provides recommendations to enable the wider use of AML to stem environmental crimes. Yet it also highlights the limitations of such an approach in terms of scope, effectiveness, and the likely inertia in securing practical, scaled outcomes. Notably, we point to an in-built limitation in the potential of AML in its exclusive focus on illicit financial flows, rather than the environmental crime itself. This means that AML rules are not currently useful where sources of legitimate financing are fully aware of, and indeed may be implicitly benefiting from, economic activities dependent in part or wholly on ecosystem services linked to environmental crimes, in effect another form of money laundering, albeit largely unintentional.

Given these limitations, Finance for Biodiversity's recommendations extend beyond the wider application of AML in proposing an approach that would seek to break once and for all the connection between legitimate financing and environmental crimes. Specifically, proposed is to advance a new due diligence mechanism requiring financial institutions to ensure the absence of environmental crimes in their financing value chain, with a focus on being able to demonstrate the absence of any beneficial interest in the economic value associated with such crimes.

Important precedents exist for such a development, notably in regulations aimed at ensuring the absence throughout the value chain of slavery, conflict diamonds, and corruption. That said, F4B remains neutral as to the merits of different mechanisms, with or without regulations, as this has not yet been examined or outlined in this report. Thus, with the core aim and overarching recommendation in mind, this report concludes with a series of proposed next steps that together make up a roadmap for advancing towards environmental crime-free financing value chains:

Mapping the landscape: there is an urgent need to develop the breadth and depth of empirical evidence, notably to establish the breadth and depth of linkages between financing and environmental crime. There may be merit in establishing an online, digital map highlighting the specifics of this relationship, which would be of relevance to identified as well as other interested parties.

Making AML work: the more intensive application of AML to environmental crimes is a work-in-progress involving many actors in and around the financial community. Progress could be made by the UK's Financial Conduct Authority (FCA) in ensuring that regulated financial institutions respond collectively, systematically and transparently to new mandatory due diligence requirements associated with deforestation, due to be applied to non-financial businesses but without doubt of great relevance to the financial community.

Environmental crime-free due diligence: going beyond AML, there is an opportunity for the financial community, with interested stakeholders, to develop and adopt more extensive due diligence that enables them to ensure they are not unintended supporters, or beneficiaries, of environmental crimes. Failing such voluntary action, or building on such action, there will eventually be merit to consider enabling regulatory measures.

Breaking the Environmental Crimes-Finance Connection is Finance for Biodiversity's contribution to the UK Government-sponsored Global Resource Initiative (GRI), a multi-sectoral taskforce assigned to provide recommendations on greening the UK's international supply chain footprint. Although preliminary in its findings, it does outline a practical basis on which the link between environmental crimes and finance, both illicit and legal, can be broken. We hope that all leaders and institutions that wish to be on the front line in ridding the world of environmental crimes by making them visible and unprofitable as well as illegal, will support these recommendations.

2

Fundamentals of the Environment in Financial Crime

Anti-money laundering largely deals with the regulations that aim to prevent proceeds of criminal acts from being disguised as legitimate. While different jurisdictions have their own laws pertaining to AML, global standards for determining offences and setting preventative measures are put forward by FATF.[1] The specific crime in question is called a 'predicate offense', which is the underlying criminal activity that generates proceeds to be laundered.[2] For instance, a predicate offence could be illegal mining which results in profits that may be laundered. Many countries choose to utilise an 'all crimes' approach to tackling environmental crimes, meaning all eligible proceed-generating crimes would automatically be considered a predicate offence for money laundering.[3] This is important, as it allows for illegal environmental degradation of all forms (deforestation, fishing, mining, waste etc.) to trigger a financial crime event.

Financial institutions (FIs) are required to report knowledge or suspicion of money laundering or laundered property through Suspicious Activity Reports (SARs). While the reporting requirements and agency vary depending on the jurisdiction, they allow regulated FIs a means to report suspected instances of money laundering, fraud, or terrorism financing.[4,5] These reports can be tied to FI employees, customer transactions, computer hacking, and other activities. To identify suspicious activities, FIs utilise mechanisms to screen investments and transactions. For instance, Know Your Customer or Customer Due Diligence (KYC or CDD) processes provide a screening step before customer onboarding to understand the nature of a customer's business and professional relationships. Analysing payment structures through transactional behaviour and areas of operation also helps monitor activities of existing customers.[6]

Luckily, these financial screening mechanisms have the capacity to detect environmental crimes within the financial supply chain, and FIs already track occurrences of environmental crime (most often tied to wildlife trafficking) within their supply chains. Conventional application of these checks tends, however, to focus on illicit financial flows passing across an FI's balance sheet. While important, this does not typically capture FIs benefitting financially from environmental crimes associated with an investment or other financing arrangement. That is, although a predicate offence may have occurred, if an FI finances a business with environmental crimes associated with its operations (either currently or historically) and whose revenues are used to repay the FI's loan, this does not currently trigger a money laundering event under the conventional application of financial crime. This report argues that existing financial crime legislation could and should be practically extended to include the benefits of environmental crime within financial flows, and considers how internal financial due diligence mechanisms can be leveraged to remove environmental crimes from global supply chains.

3

Environmental Crimes Count

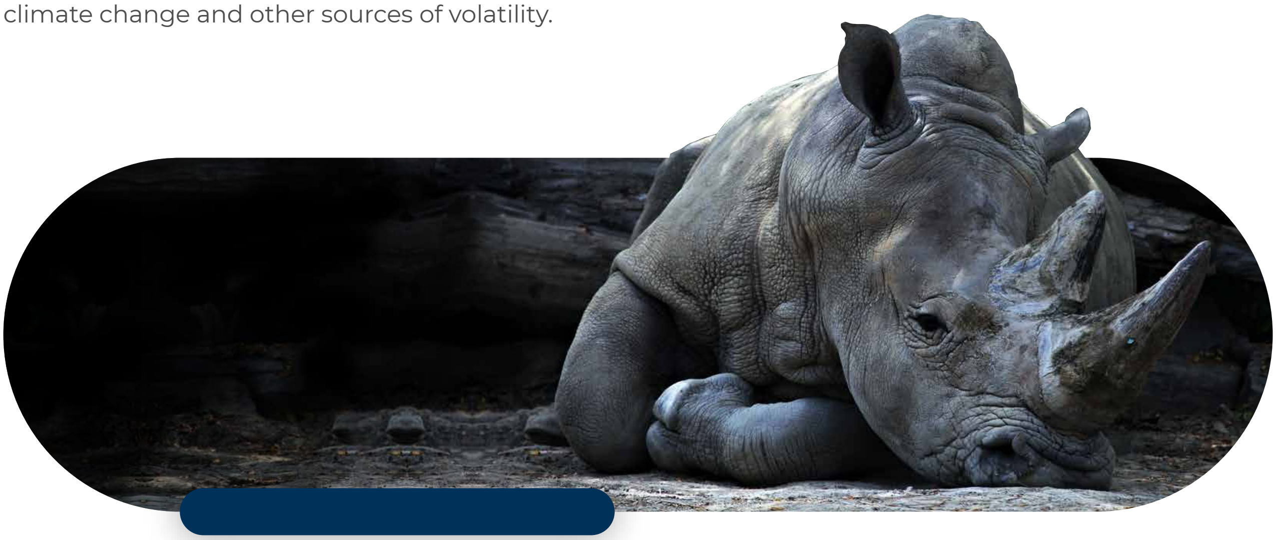
Environmental crime is in the top five most profitable global criminal enterprises,[7] generating up to almost US$300 billion annually, according to the global money laundering and terrorist financing watchdog, FATF.[8] Government losses from tax revenue are also considerable, amounting to nearly US$30 billion per annum.[9]

Environmental crimes cover a wide range of unlawful activities. To date, AML regulation has been applied to environmental crime mostly in the context of the illegal wildlife trade.[10] More recently, the practical application of AML rules across a broader range and number of environmental crimes has generated some interest, as highlighted by FATF's recent report on the topic[11] as well as by the G7's 2030 Nature Compact.[12]

Stakes are high. There is growing public demand for environmental responsibility from public and private actors. Nearly half of the world's tree species are at risk of extinction, with agriculture-related clearing (both crop- and livestock- based) representing the largest perpetrator for this die-off.[13] Indeed, at least sixty-nine per cent of tropical deforestation for agricultural commodities was conducted illegally.[14] Environmental and biodiversity loss hampers efforts to meet climate goals and hinders resilience to climate change and other sources of volatility.

Deteriorating biodiversity and ecosystem services undermine livelihoods, and for some regions and countries entire economies, as the Dasgupta Review[15] highlights alongside the recent World Bank report, The Economic Case for Nature.[16] Unchecked routes for environmental crime enable the continued illegal trade of people, drugs, and weapons,[17] and has been deemed by the UN Security Council a serious threat due to its proceeds sustaining militant groups and terrorism.[18]

Consideration of environmental crime's role in money laundering is not new. The non-profit, financial, and policy sectors have recognised the close link between wildlife trafficking and other illicit financial activities. Inter-governmental organisations, such as INTERPOL[19] and UNODC,[20] engage in transnational enforcement and regulation of environmental crime, and recognise its indirect involvement in other serious criminal activities, such as narcotics and terrorism. Efforts to date make a compelling case for addressing illicit financial gains from environmental crime, but also show the difficulty of enforcing culpability of financial actors in inadvertently supporting these criminal activities.



4

Growing Focus on Environmental-Financial Crime Nexus

Finance is implicated, but not currently held accountable, for the extent its dealings are derived from environmental crime. In the context of AML law, regulators have generally not enforced FIs without the explicit laundering of money across their balance sheet. This means a financier may gain benefits from environmental crimes within their investee's supply chain, but they are not held accountable for providing financing that supports environmental crime.[21]

Even with the best intentions, it is often difficult for financial institutions to detect if a crime has been committed, and whether the proceeds they derive are indeed criminal. Highly complex transactions and supply chains often result, for example, in blended sourcing from legal and illegal origins, making traceability even more challenging. That said, digitally-powered innovations, from satellite imagery to blockchain, are rapidly removing these practical constraints to better understand where and how environmental crimes exist and intersect legal financial arrangements.

An expanded practical application of existing financial crime regulation, particularly AML, could implicate FIs benefiting from environmental crime, but there is no case law to justify action. FIs can be held liable for dealings that benefited from or resulted in an environmental crime. Yet, it is perfectly possible, indeed business-as-usual, for financing to flow to land-use businesses which depend on, benefit from, or carry out ongoing or past environmental crimes. This makes the pursuit of environmental crime a prioritisation rather than an interpretation issue. The key is to enforce culpability beyond on-balance sheet illicit funds, to include when a regulated financial institution has benefited from supplying services to organisations that engage in or benefit from environmental crimes (for example, by purchasing assets obtained through criminal acts).

Environmental and social accountability in FI governance ethics is increasingly demanded by the public. Globally, there is increasing attention being paid to how the business and financial communities execute their business operations in accordance with environmental and social sustainability. As high-profile events showcase the demands consumers and shareholders have for business conduct (such as court orders imposed on fossil fuel companies to cut carbon emissions, and shareholders electing activist investors to the board[22]), one can foresee increases to quantity, quality, and diversity of regulations across numerous aspects of climate and environment.

More stories are coming to light of FIs investing in businesses participating in environmental crimes. Numerous companies have been exposed through undeniable proof of participating in deforestation and violating the rights of local indigenous communities. While proof of these illegal business dealings is well documented, FIs supporting these business operations through investments are not facing any risk of liability.[23,24] Even though illegal activity is documented, the finance community typically does not suffer legal repercussions from the benefits they derived from the crime taking place.[25]

FIs do not view their benefits nor engagement in these investments as a liability or credit risk, respectively. This is due to the lack of practical application of financial crime litigation imposed on the benefits and participation in environmental crime, and the incredibly low likelihood that major operators would risk insolvency.

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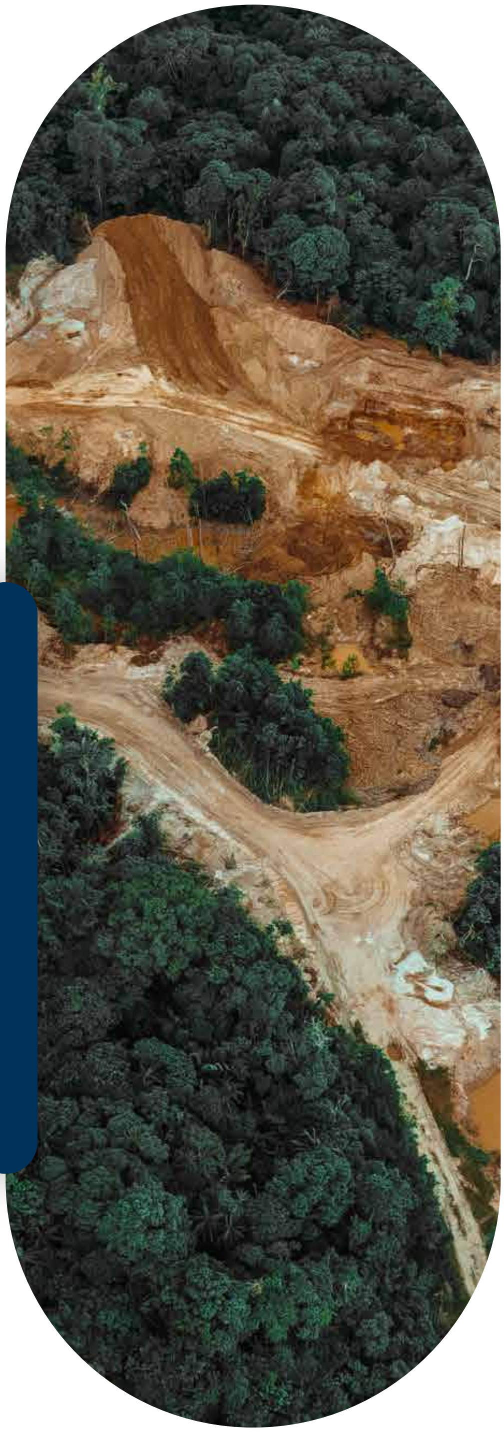
The repurposing of AML rules to strengthen recognition of environmental crime as financial crime is attracting interest. The clearest evidence of this is FATF's report on the recognition of AML rules' applicability to a broader spectrum of environmental crimes.[26] The recent recognition of AML regulatory relevance to environmental crime by FATF was well received by the Finance Ministers of the G7[27] and G20,[28] who have confirmed their support for the implementation and strengthening of efforts to combat money laundering and environmental crime.

Other initiatives are indirectly raising interest in the broader use of AML rules, including several climate-related efforts to establish due diligence obligations (DDOs) for financial institutions concerning environmental crimes associated with financing activities. For instance, the GRI is recommending that the UK consider options for advancing such DDOs for financial institutions through regulatory measures.[29] This is linked closely to the work of the Task Force on Climate-related Financial Disclosures (TCFD), the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), and the recently launched Taskforce on Nature-related Financial Disclosures (TNFD) supported by the UK Government and hosted by the Green Finance Institute (GFI).

Governments have begun considering ways to bolster the environmental accountability of the business and finance community. In import countries, such as the UK, US and EU, policymakers are implementing regulations to control operations of the business community. The UK government has supported the creation of the GRI to consider actions the UK can take to green its international supply chains and leave a lighter footprint on the global environment.[30] Additionally, the forthcoming Environment Bill would require eligible UK companies with forest-risk commodities in their supply chains to conduct due diligence to prove their supply chain is free of production on illegally occupied or used land.[31] In the EU, the European Commission's 2018 AML Directive explicitly references environmental crime under the law's current interpretation,[32] laying the groundwork for future applications to financial beneficiaries. In the US, legislation is being considered that would ban the importation of products with illegal deforestation in its supply chain.[33] Several cases involving environmental crime have been referred for further investigation within the judicial process based on financial legislation.

In export jurisdictions, such as Brazil, Colombia, Ecuador and others, countries are actively employing policies that can curb the destruction of their environment and natural resources. Seven Amazonian countries signed the Leticia Pact,[34] which establishes an information-sharing network to increase transparency amongst countries for environmental crimes. Brazil has also committed to expand its current public reporting regulations to include financial beneficiaries for increased transparency of in-country operations.[35]



While proposed regulations do not directly enforce financial institutions, they magnify the linkage between finance and corporate borrowers. Corporations need financiers to support their operations, and financiers need profitable corporations to secure revenue streams. The forthcoming due diligence requirements could impact a significant proportion of corporate borrowers in the market. If impacted corporations are unable to illustrate the absence of environmental crime in their supply chain, they may face considerable risk to their operational volume and supply chain structures.

Furthermore, financiers may not have enough insight into their borrowers' supply chains to understand how vulnerable they are to regulatory violations. Financial institutions might require clients to hold larger amounts of capital should environmental crimes be identified in their operations. If financial institutions deemed the uncertainty in the supply chain was too great, it could ultimately result in different sectors or regions seeing a massive withdrawal of investment activity. As a result, financiers could face a competitive disadvantage in the global market due to the consequences of this uncertainty for multiple facets of trade (financing, import and export fraud, etc.) and the need for FIs to track these issues across proliferation financing and trade-based money laundering in addition to their investment activities.

5

Breaking the Environmental Crime-Financial Crime Connection

5.1 Implications of accountability measures on the business and financial sectors

It is unclear what the repercussions of emerging new due diligence requirements are likely to be. As the suggested regulations are novel, it is difficult to understand how their effects will manifest because of varied formulations of legislation across jurisdictions. We can, however, assume that with current levels of attention and momentum, forthcoming legislation and associated impacts will spread quickly. Regardless of the ultimate form of the regulatory landscape, growing attention to environmental crime has already begun shaping a new risk map for international supply chains, proven by the fact that FATF has already produced a report on the importance of environmental crime in financial regulation.

What is clear is that conventional approaches to financial reporting regulations have a longstanding history of challenges. Historically, approaches to enforcing reporting and regulatory compliance in corporate and financial systems fall into two distinct categories: voluntary and statutory. Voluntary measures allow institutions in question to slowly adopt the regulation without demanding too much cost or capacity upfront (or indeed, adopt the measures at all). There is, however, often not sufficient incentive for market behaviour to shift. Statutory measures mandate institutions change their behaviour, yet this approach can be practically infeasible as it receives substantial pushback from institutions due to the resources, data and expertise required to effectively comply.

Placing boundaries around culpability and duty to prevent FIs benefiting from environmental crime in financial activities is challenging. Indeed, a fundamental challenge contributing to the limited success of both voluntary and statutory measures is the nuance of defining complicity of financial institutions in environmental crime. This is due to complex supply chains that make it hard to define the liable party. Some frequently cited challenges are:

How is the environmental crime defined?
Is a financial institution held under the criminality definitions of their home country or those of their borrowers' home countries?

When did the environmental crime occur?
Does a financial institution hold responsibility for environmental crimes exclusively during the lifetime of their investment, or does that culpability extend to before or after the investment was made?

Where in the supply chain did the environmental crime occur?
Is a financial institution accountable solely for the activities of their borrower and/or also for any sub-contractors a borrower hires in their operations, and if so, to what degree of sub-contracting activity is the financial institution liable?

The lack of boundaries makes it difficult for crimes falling under AML provisions to be identified. One can see how these questions can be compounding, making it even more difficult to compile clear evidence of wrongdoing, both in the evidence of FIs undertaking an illegal act or failing to prevent their engagement in a criminal act. The growing momentum and attention from public and private actors make enforcement in this nebulous environment increasingly likely. What's needed is a leverage point to signal the need for the repurposing of existing frameworks, both for FI due diligence and regulatory enforcement.

5.2 Opportunities for success via a middle-ground approach

The Environment Bill presents the UK financial community with an opportunity to take the middle road. As mentioned, the Environment Bill will impose legal compliance on eligible members of the nonfinancial corporate sector to identify whether their commodities were illegally produced (either by converting forest to agricultural land or into the commodities themselves) within their supply chain. While not directly implicated in the upcoming regulation, this will have a catalysing effect for the financial community for two key reasons:

- The UK's international supply chains may see substantial shifts in business volume and restructuring of corporate sourcing of materials; and
- There will be an avalanche of data highlighting risks that are not curently considered by the market.

This presents an opportunity for FIs to choose the middle path between voluntary and mandatory regulation. While the direct links between FI lenders and corporate borrowers mean FIs will ultimately need to address the new risk landscape, this middle road allows FIs to identify a standardised and widely accepted methodology to process these data flows on their terms.

For a middle road to work, FIs need a standardised mechanism that can take account of this new data flow through a relevant lens. That is why AML regulation's application as a due diligence tool presents a particularly harmonious methodology to be applied to this approach, as it is already widely operationalised within FI risk management frameworks globally. Additionally, as financial crime standards could be reprioritised in practice to include the financial support and benefits of environmental crime, it would remove the need for FIs to understand and internalise an entirely new set of regulations.

While its practical application towards environmental crime would be new, the utilisation of a pre-existing financial crime monitoring framework allows one a good understanding of what behavioural effects there might be from numerous stakeholders. Ultimately, the utilisation of a top-down approach to due diligence reporting through tools like AML may help drive enforcement and compliance through the supply chain.

The repurposing of AML due diligence could support newly presented risk without new regulations for the financial sector. For instance, if an FI wanted to ensure a corporate borrower did not have environmental crime in their supply chain, they would warrant the company be compliant with the imposed regulation. To prove they are compliant, corporates would need to supply new information in line with AML due diligence requirements. To guarantee they can comply with the warrant and supply the required data, corporations would then work with in-country partners (governments, suppliers, non-profits, etc.) to acquire the data needed.

Over time, applying due diligence at the financier level strengthens the direction of current risk frameworks (including reputational, credit, and liability-based risk), as well as build quality surrounding data and enforcement on environmental crime in-country.

5.3 Advantages for prioritising environmental crime in financial due diligence

The regulatory groundswell to monitor environmental degradation in global supply chains presents an opportune catalyst for regulators to encourage widespread adoption of a harmonised due diligence approach across the financial sector. As increased pressure and attention is coming from numerous stakeholder groups, FIs have a zero-risk market advantage to engage on a middle road approach now. The growing momentum at the intersection of environmental crime and AML rules, as exemplified in the FATF report, can be effectively leveraged by the existing experience of governments, judiciaries, and financial regulators. It can also build on the existing engagement of these regulatory bodies regarding climate and environmental issues, albeit recognised as financial stability and market integrity issues.[36]

Moreover, it aligns with the growing willingness of societies to respond ambitiously to the climate emergency. One must recognise these crimes do not happen in isolation, and therefore generate pressure from stakeholders in environment, human rights, labour rights, anti-terrorism, and many other disciplines. The longer the financial community takes to adopt a due diligence standard, the more likely FIs are to be forced into a reactive position once foreseeable increases in the quantity and quality of data and environmental crime regulation come forward.

In the short-term, financiers would benefit from increased supply chain transparency to accurately price risk. Without a risk framework such as AML in place, financial institutions jeopardise mispricing the exposure of their investments. Embedding environmental crime into AML frameworks would help financiers overcome the paucity of data regarding environmental crimes, and establish a more robust internal due diligence process of prospective financing decisions.

In the long-term, jurisdictions with these frameworks could hold a market advantage. Risk infrastructure takes time to adapt, and regulatory bodies that implement these frameworks early will have more time to refine their culture and expertise in managing risk. As it is foreseeable that environmental risks will increase in the future – both from environmental degradation and strengthened environmental regulation – markets that have resiliency built into their financial governance structure will be a more attractive investment than those taking a reactionary approach to market enforcement.

We have seen what happens when FIs are not adequately prepared to deal with new reporting regulations. The financial community has already dealt with rapid changes to its risk and regulatory landscape, and the associated repercussions. Before September 11th, 2001, money-laundering controls were largely focused on drug trafficking and financial fraud. While these controls existed and had authority to monitor and regulate terrorism-associated financing through money laundering, it was not a regulatory priority.

Markets that have resiliency built into their financial governance structure will be a more attractive investment.

After the terrorist attacks on the US, it was discovered that most of the financing needed by al- Qaeda had passed through US-based bank accounts.[37] By the end of October 2001, US Congress had passed new legislation requiring due diligence of banks in their relationships and transactions with customers. It expanded predicate offences, expanded the government's forfeiture authority, and increased government procedural authority to obtain bank records (even those maintained overseas).[38] 9/11 had ripple effects across global financial reporting as well. In addition to the EU Directive's 'gatekeeper' provisions implemented in October 2001 (requiring lawyers to submit evidence of suspicious transactions), the UK's Anti-Terrorism

Act, Crime and Security, 2001 amended the Terrorism Act of 2000 making it law to immediately report knowledge of a person committing an offence related to funding terrorism or laundering terrorist funds.[39] All these regulatory amendments and introductions resulted in a massive amount of data for FIs to track, understand and report on, along with a suite of complex regulations associated with hefty fines for noncompliance.

Indeed, we can see the trajectory of environmental crime's role in financial crime as analogous to the aforementioned example. It is important to see that similar trajectory now, and recognise how tools like AML due diligence can be an incremental approach that allows a preventative approach, before needing to spend more money, increase staffing, or other expensive measures to comply with new, externally mandated regulation.

Accountability has already come for the financial community in other parts of the environmental landscape. One that has garnered particular attention is the Prudential Regulation Authority's (PRA) supervisory statement SS3/19,[40] which identifies the expectation that a firm oversees and assesses risks imposed by climate change to the firm. In particular, the PRA expects that a Senior Management Function (SMF) is appointed to accept personal responsibility for the identification and management of climate risks.[41] This is important, as it drives personal accountability to the board level and imposes personal liability should SMFs be in breach of their duties.

While this does not currently apply to a broader context of environmental crime, one could see the opportunities for these kinds of regulatory actions to be imposed for environment and biodiversity in the future. Other organisations – particularly in the civil society, human rights, and environmental communities – are actively pushing for mandatory and more exhaustive due diligence from global financing and commodity supply chains,[42] citing lack of urgency and increasing trends of deforestation under current regulations and commitments. As data improves and pressure mounts, regulators will need to respond. If FIs take steps now to adopt standardised practices to understand supply chain risks in their business dealings, this action would support a more resilient business, and also protect the tenure of senior representatives responsible for compliance.

5.4 Breaking the Environmental Crime-Finance Nexus

In principle, the link between environmental crimes and financial flows can be broken through the wider and more effective application of AML rules. This is notably true where financial institutions are conduits for illicit financial flows associated with environmental crimes. Moreover, it is also the case for legitimate financing that benefits from environmental crimes. It is this core conclusion regarding the extended application of AML rules that leads us to recommend actions to realise, as far as possible, this potential.

In practice, it is important to recognise the limitations as well as the potential of AML rules in reducing environmental crimes. Many of these limitations have been highlighted above, such as the difficulty of spotting illicit financial flows linked to environmental crimes, particularly if they are blended with legal financial flows. Moreover, national regulators, on which enforcement depends, are of varied quality, not least because of their differing capabilities. And with the increasing competition across global financial markets in mind, there are inevitable pressures on regulators to minimise regulatory burdens that might disadvantage particular financial centres over their international counterparts. Collective action, even with the presence of a strong, international financial crimes community, is inevitably slow and tends to be conservative relative to the potential and need.

Beyond such practical limitations, the core issue concerns the link between environmental crimes and entirely legal financing arrangements. As highlighted in earlier sections, there are widespread examples of entirely legal financing, say from a bank or asset manager, of entities that are profiting from environmental crimes. Often such crimes are not committed by the entity being financed, although they may be committed in part by criminals aware of the additional profits that might accrue through the benefits such crimes can provide to entirely legitimate business activities.

In such situations, the legal financing in effect benefits from the environmental crime through the latter's positive impact on the profitability of the entity being financed. In effect, this is a form of money laundering that realises the gains of environmental crime in legitimate financial flows. In principle, this form of money laundering should and could be addressed through the application of existing AML frameworks. In practice, it is not. Moreover, our discussions with many experts and practitioners in the financial crimes arena indicated in their view how difficult it would be to deem such beneficial relationships and associated financial flows as falling foul of AML rules. Clearly establishing case law would advance this aspect of the agenda, and this may be progressed in practice by litigation initiated by civil society organisations and other advocates of environmental protection.

There is a clear case for acting to ensure that financial value chains are environmental crime-free.

Alternatively, a different pathway could be taken in seeking to establish liability of financial institutions resulting from beneficial relationships with entities that profit from environmental crimes. Certainly, there are precedents in establishing rules requiring businesses, including directly or by implication financial institutions, to ensure that their value chains are absent of a designated phenomenon or product. The Kimberly Process, for example, resulted in US regulations requiring value chains to be free of so-called 'conflict diamonds'. Comparable regulations exist as measures to ensure the absence of slavery and corruption in value chains.

Some existing and proposed pieces of legislation attempt to limit profitability from environmental crime. For instance, the US Lacey Act makes it illegal for anyone in the US to purchase, import, export, or acquire illegally captured animals, or illegal forest or animal products across US state lines or international borders.[43] Additionally, the proposed FOREST Act in the US aims to prohibit commodities produced on illegally deforested land from US markets, and includes illegal deforestation as a financial crime statute.[44] While these efforts are promising, they still do not apply to the billions invested by US investors into forest-risk companies.[45] The benefits derived from these investments must also be included in these regulations, as they ultimately sustain business operations dependent on environmental crime.

Adopting a brand new 'environmental crime-free' regulatory requirement would, however, be complex and onerous, and certainly meet significant resistance from the market, and possibly from regulators not wishing to take on additional roles. It may be that the adoption hurdle would be lower if there was already related due diligence requirements in place or plans to establish them. This might be the case, for example, if one or more jurisdictions established mandatory deforestation due diligence requirements, as already planned in the UK and Europe, and probably more extensively given the new, high-level zero deforestation commitments made at COP26 in Glasgow. In such circumstances, the additional requirements would be more modest to ensure that value chains are free of illegal deforestation activities and any associated beneficial outcomes.

Whichever combination of mechanisms may eventually be used, there is a clear case for acting to ensure that financial value chains are both environmental crime-free, and that financial institutions are not beneficiaries of environmental crimes, intentionally, knowingly or otherwise.

6

Recommendations and Conclusions

The preceding sections highlight the fact that there are many moving parts to any strategy to address the aim of eradicating environmental crimes through a focus on associated illegal and legal financial flows. Clearly, there is much to be gained from making full use of anti-money laundering rules and institutional arrangements including regulators, and a more collaborative risk assessment approach between public, private, and civil society members to support a robust understanding of financial exposure to environmental crime. In addition, there is scope for more extensive use of voluntary action by the financial community, for example, through the adoption of emerging due diligence mechanisms.

Such developments are practical, and potentially of great significance in reducing environmental crimes. That said, there are many challenges in turning potential into reality. It is important, therefore, to consider additional avenues. For some, campaigning and litigation may be a way to go, and although troubling, such actions might eventually accelerate the more extensive use of AML rules. Broader approaches to ensuring the exclusion of environmental crimes from financing value chains might also be considered, drawing on experience such as the approaches to conflict diamonds, slavery, and corruption.

6.1 Recommendations to the UK Government

The UK can and should take leadership in championing an initiative to advance this approach. While FATF's 2021 environmental crime report lays the foundation of further engagement, international action is almost always precipitated by unilateral first movers, such as the Bank of England's decision to commence the world's first climate stress test ever to be undertaken by a central bank.

The UK's net zero commitment, the proposed Environment Bill, existing climate and biodiversity commitments, and its key role in hosting COP26 reinforce the clear case for it to champion this space. Additionally, the UK's approach to react towards all crime proceeds means the financial sector should already have mechanisms in place to report any detection of proceeds generated by illegal deforestation. Moreover, the key position of the City of London in the UK economy, and the UK internationally, supports the UK in advancing an initiative to strengthen the use of AML rules in combating environmental crime.

6.2 Recommendations to financial regulators

Financial authorities should take the first step to understand what these new shifts mean for institutions under their reporting mandate. Before embarking on its climate agenda, the Bank of England posed a similar question: "Does climate change existentially alter how we make our financial decisions?" The Bank then proceeded to conduct a survey of insurers to understand the risk climate change posed to their investments.

The Financial Conduct Authority (FCA) could take a similar approach by surveying the institutions under its regulatory mandate. The FCA must first pose the question: "Given foreseeable changes to the risk landscape of your investments, does this impact your ability to comply with existing financial reporting? If so, what existing due diligence mechanisms (such as KYC, CDD, and other pieces of the AML framework) could be relied on to ensure compliance?" This would afford FIs the opportunity to agree on a standardised approach without an immediate risk of mandatory enforcement. They can then determine the most effective tools available now that can readily incorporate the heightened flow of environmental crime data, and with support from investigative services by the National Crime Agency (NCA), begin prioritising a more practical application of these tools to benefits from environmental crime.

6.3 Recommendations to the wider community fighting environmental crimes

There is a growing community of actors active in advancing finance-related actions to eradicate environmental crimes, including those with a long track record such as TRAFFIC in addressing illegal wildlife trafficking, and new coalitions such as the recently established Environmental Crimes Alliance. In addition to working with governments, regulators and financial institutions willing to take leadership, we would highlight the merits of three spheres of action:

> First, is the need to improve the empirical evidence of the breadth and depth of the links between environmental crimes and entirely legitimate financing providers, and the impacts of such links in terms of environmental effects and arising benefits to financial institutions and the organisations they fund.
>
> Second, is the need to ensure that emerging frameworks to advance the quality of financial institutions' environmental-related risk assessment and reporting - such as the TNFD - take account of and prioritise their importance in underpinning effective environmental crimes-related due diligence.
>
> Third, is the need to explore the merits and implementation options in advancing requirements for FIs to demonstrate their financing value chains are free of environmental crimes and any beneficial flows associated with them. This should include consideration of both voluntary actions and standards, and the potential for regulatory measures, perhaps in the first instance linked to emerging due diligence requirements regarding deforestation.

6.4 Conclusion

In conclusion, we would urge financial institutions, governments and regulatory bodies to recognise and respond to the groundswell of attention and policy consideration surrounding finance and business responsibility in environmental crime.

Such attention should not be treated by financial institutions as a reputational problem to be mitigated, but as an opportunity to de-risk and so build resiliency into their financing value chains and risk-adjusted returns.

Moreover, policymakers and regulators, working with financial institutions, should see the opportunity to gain competitively from being the first movers in eradicating environmental crime from financial value chains, much as we have seen over recent years financial centres compete to be globally recognised as free of corruption, or more recently to become a prime green finance hub. We hope that this report offers not just a call to arms, but a clear value statement of the merits of moving ambitiously on this agenda, and a roadmap for key actors in turning ambition into action.

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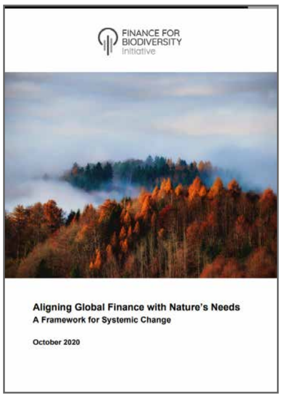

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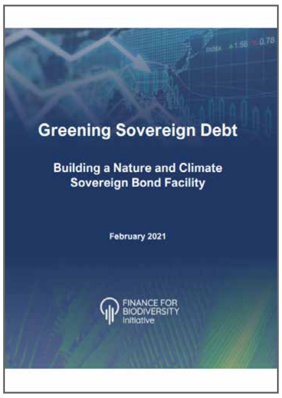

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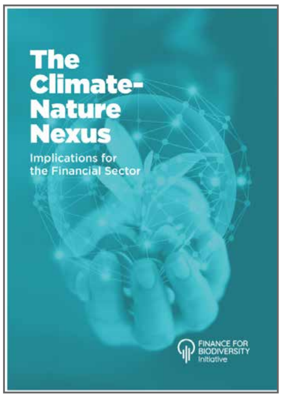

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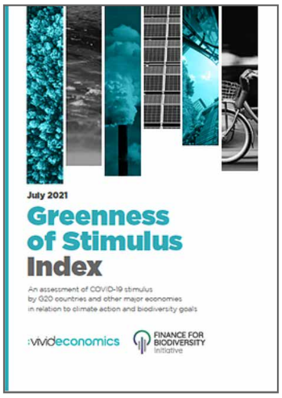

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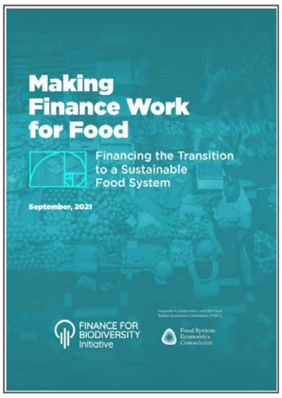

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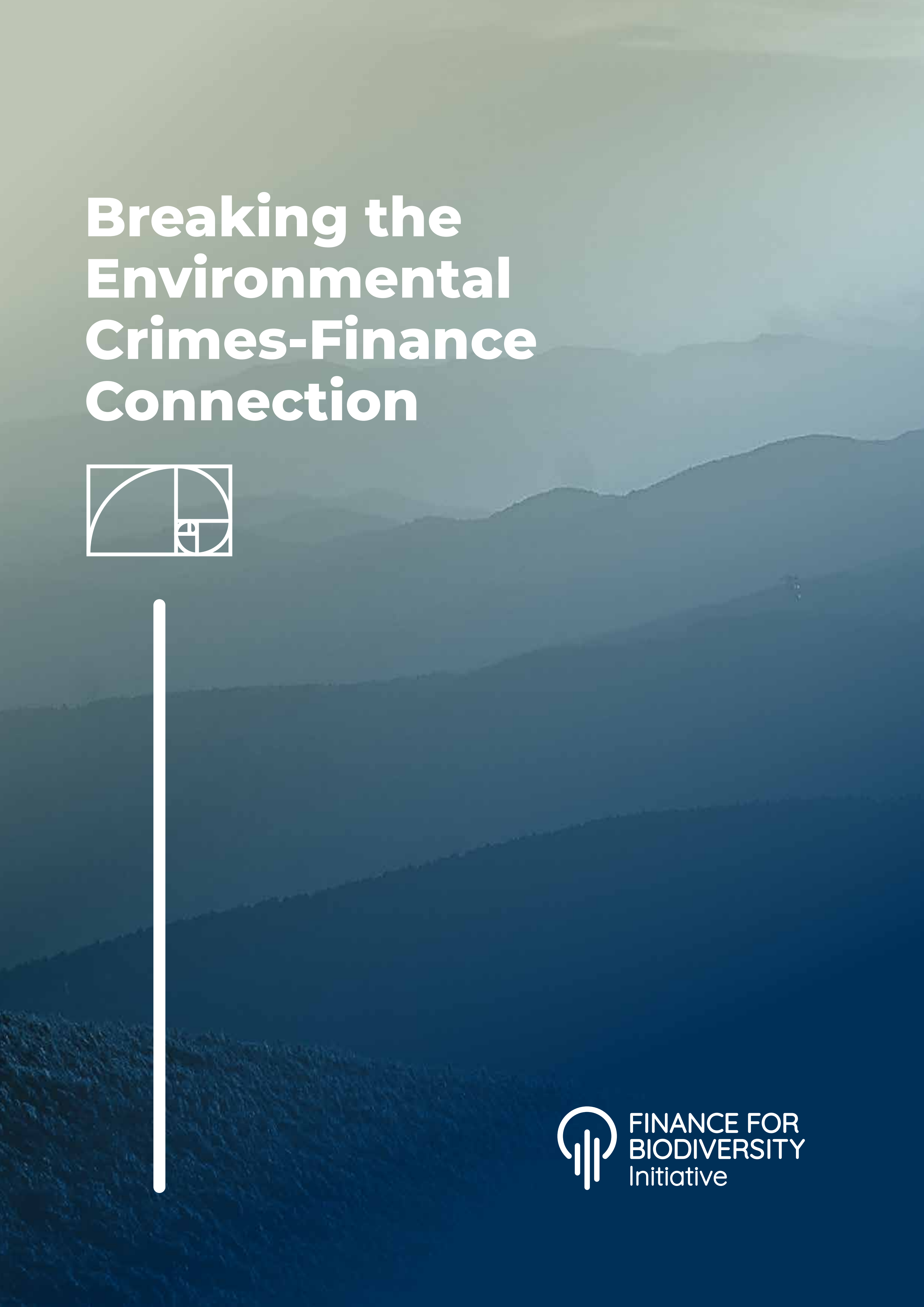

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