Follow the Money: how profitable environmental crimes contribute to climate change

Behind much of the environmental destruction and climate change that the ESG agenda seeks to combat lies a highly profitable underground economy that the Financial Action Task Force (FATF) estimates is worth $110 bn – 281 bn every year. Yet financial crime related to environmental and social issues is under-reported and its significance underestimated.

Arab Banker asked Elizabeth Humphrey, a financial crime researcher at Themis, a specialist anti-financial crime platform, to explain the connection between environmental damage, climate change, and financial crime.

In recent times the novelty of the so-called 'ESG agenda' has started to wear off. For some banks, the temptation is now to treat ESG as a tiresome set of box-checking exercises necessary only to avoid regulatory fines and reputational risks. As this weariness creeps in, it is essential that we recall the underlying human and environmental purposes of the ESG agenda and revisit how banks can most powerfully leverage their position as the repositories of global money to drive the ESG agenda forward.

Banks, and all of us, would be wise to remember the catchphrase, 'follow the money'; and in ESG, there is plenty of money to follow.

Organised crime groups (OCGs) and financial criminals are some of the most powerful players contributing to ecosystem destruction and climate change – yet they are often forgotten in discussions regarding the climate crisis.

As a result, the proceeds of environmental crime go relatively under-detected and under-prosecuted compared to many other predicate crimes to money laundering such as drug and human trafficking.

Banks can promote the ESG agenda through more effectively embedding detection of environmental crime networks and flows within their broader financial crime control systems. In doing so, they can leverage increasingly sophisticated anti-money laundering (AML) due diligence technology to detect customer, supplier and investment linkages to environmental crime and put an end to environmental crime profits moving through their own coffers. As the world prepares for COP28 later this year, a focus on environmental crime gives financial institutions an opportunity to show that they are participating in the full range of solutions to climate change.

Environmental crime is a predicate crime to money laundering

At first glance, financial crime and climate change may appear unlikely bedfellows. However, a closer look reveals their cyclical, co-reinforcing nature. At the heart of what one might call the 'financial crime/climate change nexus' is a whole range of highly profitable environmental crimes, from the illegal wildlife trade (IWT) to illegal mining, logging, waste disposal, and pollution, proceeds of which criminals seek to launder through legitimate financial institutions. While no single definition of environmental crime exists, the European Commission's definition considers it as any act that breaches environmental legislation and causes significant harm or risk to the environment and human health.

These illicit activities wreak havoc on the earth's ecosystems, capture whole local economies, and foster socio-political instability – consequences that in themselves demand global attention. Implications for global warming add still more urgency to the problem: in destroying key ecosystems, criminal activity devastates naturally occurring carbon sinks, which provide approximately one third of the emissions reductions needed to keep global warming below 2 degrees centigrade.

FATF makes clear that climate change and related environmental devastation cannot be fought in isolation. To address it, we must dismantle the profit and incentive structures driving organised criminals and illicit businesses toward environmental crime. Banks can lead the way through robust due diligence processes.

Elizabeth Humphrey

Elizabeth Humphrey is a financial crime researcher in the Themis Insight team and a PhD Candidate at the London School of Economics. Elizabeth analyses financial crime risks facing specific jurisdictions and industries, with a particular focus on illicit financial flows linked to informal mining. She has previously worked as a political risk consultant for natural resource companies operating in Africa and the Middle East.

Thinking like a criminal: environmental crime as a path to profit

While we often condemn environmental crime on moral grounds, the drivers are material – few people are interested in damaging the environment as an end in itself. Behind environmental crimes are massive financial incentives: a huge underground illicit economy that is growing at 5–7% per year, according to the European Commission. That is two or three times faster than usual rates of global economic growth.

There are a range of reasons for this rapid growth in environmental crime activities and profits. Perhaps most prominently, environmental crime is seen as a low-risk, high-reward market. Detection and law enforcement is lacking, and legal penalties are relatively lenient. Notably, although criminals rely on financial crimes including money laundering, corruption, and document fraud, courts typically charge them only with environmental crimes, which in most jurisdictions carry low penalties. As a result, many actors historically involved in other predicate crimes such as drug trafficking are strategically diversifying into environmental crime.

Profits with environmental consequences

Environmental criminals use a wide range of illicit financial tools, including bribery, document forgery/manipulation, fraud, smuggling and corruption, to facilitate their profit-making from environmental crime.

Using these tools, terrorist organisations and criminal groups smuggle precious animal products, capture unregulated mining supply chains, and undercut legal trash disposal, among many other crimes. The consequences of these techniques extend far beyond financial losses for legitimate economies, disrupting ecosystems, depleting essential carbon sinks, and leaching harmful toxins into surrounding areas.

Profits with social and livelihoods consequences

The financial crime/climate change nexus also has severe impact on people's livelihoods, and as a result, banks need to focus closely on the 'S' in ESG. Unregulated mining, for example, is a hotspot for human rights violations including child and slave labour, while so-called 'conflict minerals' often fund terrorist groups and fuel inter-communal violence and instability. In terms of illegal logging, it is estimated that 40% of all deforestation is undertaken by enslaved workers. Such land clearing also leads to more severe natural disasters, with severe consequences for local communities. Pollution and wildlife degradation increase the threat of food insecurity, disease, and mass displacement.

Illicit activity can compromise a state's ability to undertake its ordinary, legal functions. Flourishing illegal economies weaken a state's ability to deliver basic services. In a striking statistic, formal taxable revenues lost through environmental crime are estimated to be 10,000 times greater than the amounts spent to combat environmental crime.

A cycle of dependency: the political economy of environmental crime

Organised crime groups sometimes manage to capture whole local resource economies, leading to widespread dependency on underground illicit trades. Particularly when governments struggle to offer basic services and protect legitimate supply chains, populations may turn to alternative, illicit markets for much-needed income. This often leads to cycles of exploitation and coercion to maintain large illicit profit margins.

Likewise, more and more legal businesses appear to be turning toward illicit mechanisms to fill a growing profit gap. Such conditions leave communities more vulnerable to socio-political instability and, in some cases, recruitment by terrorist or criminal groups.

Climate implications of the vicious cycle

The ESG agenda encourages us to consider environmental destruction and climate change as interconnected challenges. Indeed, fighting illicit environmental destruction is key for mitigating climate change, particularly because of the so-called 'biodiversity/climate change nexus'. Net carbon emissions rise as a result of human destruction of key ecosystems, which otherwise provide an important natural carbon sequestration mechanism.

As such, climate change will only worsen as environmental criminal economies continue to flourish. Statistics are already shocking: 15% of carbon emissions come from deforestation alone, while the vast outputs enabled by modern slavery in deforestation, illegal mining, and other criminal economies together constitute the third highest carbon emitter globally.

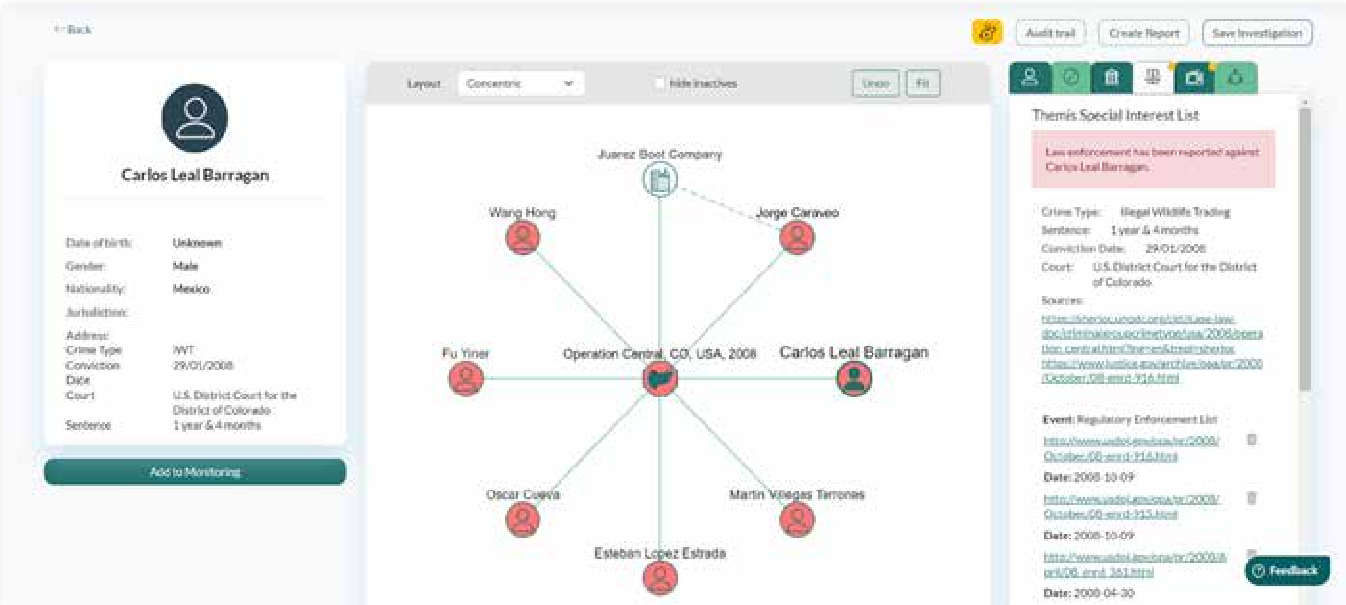
Perhaps the most urgent area to address is the illicit logging economy now flourishing under drug cartels in the Brazilian Amazon. According to new reporting by the United Nations Office on Drugs and Crime, recent years have seen organised crime groups capture whole swathes of Brazil's logging market after former President Jair Bolsonaro dismantled regulations and environmental protection agencies. Criminal groups took advantage of this vacuum to extend and tighten their control of mining and logging economies, diversifying away from the drug trade in what is now being called narco-deforestation. This has fed a cycle of exploitative reliance upon the drug cartel economy amongst local communities and massive cuts to some of the globe's most important carbon sinks.

Brazil's deforestation crisis is not the only example of environmental crime damaging carbon sinks. Incidents of mass illegal fishing, often practised alongside illegal logging, have also devastated ocean carbon sinks. Notably, vast swathes of mangrove forests located in the Bangladesh and India Sundarbans UNESCO World Heritage Site have been destroyed for illicit shrimp aquaculture camps.

If this trend continues, we will also see climate change itself feeding the growth of organised crime, bringing the crisis full circle. Greater demographic pressures and mass environmental migration will breed opportunities for human trafficking and exploitation, while severe weather and food insecurity will foster widespread instability and conflict.

Themis

Themis is an award winning, B Corp anti-financial crime specialist with a digital platform that helps clients manage their financial crime risk exposure. Themis' technology, research and investigations help organisations understand these strategic threats through an ESG and socio-economic lens and protects their customers, staff, suppliers and shareholders from criminal attacks or association.



What can banks do?

Despite growing awareness of the financial incentives behind environmental crime and implications for climate change, there is a lack of action to address these inter-connections in the financial services industry and further afield. We recommend focussing on the following points in revived efforts to address climate change rooted in financial crime and illicit economies.

- Remember why ESG regulations were put in place in the beginning. Amid complex debates around ESG ratings and concerns over greenwashing, we often forget the driving motivation behind the fashionable trend of ESG: minimising violations of environmental regulations and preventing non-compliant actors and criminals from degrading environmental and social resilience in the name of illicit profits.
- Intensify and invest in cutting-edge due diligence of environmental crimes in your suppliers', your investments' and your customers' supply chains. Ensure that AML systems track environmental crime as a predicate crime to AML and spread awareness of environmental crime red flags and detection processes to all levels of the business. Promote a broader culture of risk mitigation and due diligence led by senior management.
- See the opportunities, as well as the risks, in digitalisation and globalisation: while criminals are currently profiting from digital markets with lower thresholds to entry, anti-financial crime initiatives are also harnessing tech to fight back. Digitalisation of anti-trade-based money laundering (TBML) processes, digital tracing technologies, and intelligent AML tools provide exciting avenues for effective combatting of the financial crime-climate change nexus.
- Start prosecuting financial crimes in addition to/instead of environmental crimes. Once banks start detecting more environmental crime through AML systems, there will be more opportunities to file related suspicious activity reports and ultimately to spur more prosecution of these activities as financial crimes. Financial crimes typically possess harsher penalties than environmental crimes and are more stringently regulated. Shifting towards prosecuting for the financial crimes at play would address the current perception of environmental crimes as 'low risk, high reward' illicit markets, increasing law enforcement and legal consequences.

Looking more broadly at the country-level perspective, Themis also advocates the following measures:

- Increase regulatory focus on environmental crimes. The EU's sixth Anti-Money Laundering Directive (6AMLD) declared environmental crime to be a predicate crime for money laundering, which increases regulatory expectations on financial services to screen for potential environmental crime violations in clients and third parties. FATF's 2020 Special Report on Illegal Wildlife Trade has pushed expectations, as has Operation Thunder, a collaborative initiative between the World Customs Organization and the UN Environmental Programme (UNEP) to increase detection and law enforcement of transnational flows of environmental crime proceeds and products.
- Continue pursuing legal reforms to criminalise environmental crime more effectively. Growing frustration with the limitations of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) has led to growing efforts around the globe to increase and systematise criminal liability of companies committing environmental crimes. Chile has adopted new legislation introducing further penalties for environmental crimes. Meanwhile, the term 'ecocide', or a crime of mass destruction to the environment, has gained traction and there are growing efforts to codify the concept in France and the EU more broadly.

Themis helps clients to identify potential links to environmental crime among clients, investments, suppliers and third parties. The Themis Search and Monitoring due diligence platform - which enables clients to search for links to all criminality and adverse media – is underpinned by proprietary conviction data on a range of predicate crimes, including environmental crime and wildlife trafficking and is continually updated by specialist financial crime researchers and comprehensive data feeds.

The Themis Search map above reveals a criminal operation in which seven individuals were convicted for illegally trading a range of products, including skins from protected sea turtles and other wildlife. ■