# Environment, Social, and Governance (ESG) and Anti-Financial Crime (AFC) Convergence

## Managing AFC Risk: Applying the ESG Framework to Stop Illicit Financial Flows

ACAMS

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# Contents

# 1. Background

Anti-money laundering (AML) and sustainability interweave themselves in ensuring and protecting a firm's revenue quality and the rising social responsibility to save our planet. In June 2020 and later in July 2021, the Financial Action Task Force (FATF) published guidance on the illegal wildlife trade and environmental crime, heralding interest to incorporate ecological issues. When added to existing published research on human trafficking, labor exploitation, illicit gold mining, and financial inclusion, FATF has gradually refocused on ESG issues. Collectively, the FATF research and guidance intersects with the development of ESG frameworks. Not surprisingly, both AFC and ESG programs aim to improve the quality of financial flows. Subsequently, as anti-financial crime professionals gaze into the horizon, ESG will become more prominent within financial institutions.[1, 2]

Reading this paper will help AFC professionals to understand the role they can play, including how they can:

- Help organizations build-out ESG functions
- Link AFC processes to ESG frameworks
- Share lessons learned from AFC deployments
- Make a meaningful impact to save the planet

1. Bank of International Settlements, April 2021, "Climate-related risk drivers and their transmission channels", pp.32-33, **https://www.bis.org/bcbs/publ/d517.pdf**
2. Network of Greening the Financial System, November 2021, "Climate-related litigation: Raising awareness about a growing source of risk", pp.7&10, **https://www.ngfs.net/sites/default/files/medias/documents/climate_related_litigation.pdf**

# 2. Purpose

Regulators in the UK[3] and US[4] are moving ahead with direction. Subsequently, financial institutions should see a sunset to "voluntary" participation, as these sustainability activities become mandatory. So, the nexus between AFC and ESG will become broader than historical activities, envelope the whole organization, and increasingly become a regulatory requirement.[5]

This paper intends to:

- Define the underlying concepts of environment, social, and governance to determine metrics for measurement and applications in financial crime risk mitigation
- Review cases studies that illustrate mutually beneficial relationships between ESG and financial crime risk management
- Delineate differences between individual components of ESG to ascertain the predominant benefits and roles for strengthening financial crime risk management (FCRM)[6]

A fundamental question this paper asks is whether AFC programs should be integrated with ESG frameworks. This paper will show how AFC programs can benefit from integrating with ESG frameworks.

3. Finance for Biodiversity Initiative, January 12, 2022, "Breaking the connection between environmental crimes and finance", **https://www.f4b-initiative.net/post/breaking-the-connection-between-environmental-crimes-and-finance**
4. US Securities & Exchange Commission, October 26, 2021, "SEC response to Climate and ESG risks and opportunities", **https://www.sec.gov/sec-response-climate-and-esg-risks-and-opportunities**
5. Stuart Davies & Joseph Mari, ACAMS Today, (not published), "ESG and AML: A New Convergence or Inherent Relationship?"
6. FCRM is a compliance function managing anti-money laundering, counter terrorist financing, sanctions, fraud, and anti-bribery and corruption issues.

# 3. Defining ESG

## 3.1 Underlying Concept

There is wider recognition that human activity contributes to climate change due to the unsustainable ways individuals and legal entities extract and degrade the flora, fauna, and natural resources from the land, oceans, and air. Subsequently, ESG frameworks direct private sector firms to "promote the positive contributions multinational enterprises can make to economic, environmental and social progress."[7] While there are no established universal ESG factors, there is a body of knowledge developing around the three areas.[8]

Our land, oceans, and air are being degraded at alarming rates while juxtaposed with a growing threat from transnational criminal organizations profiting from the illegal wildlife trade, logging and fishing, modern slavery and human trafficking, and other illicit behaviors. In addition, there is a convergence of ESG, AML compliance, and social concerns prompted by investigative stories, such as the Pandora Papers, on corruption and high-profile money laundering cases.[9]

## 3.2 Defining ESG

ESG is a short acronym composed of three components, outlining an approach to investing, risk mitigation, and decision-making tools. The three components are:

- **Environment,** which examines human impact on the natural eco-system;
- **Social** concerns, which focuses on human activity and civil society challenges, and;
- **Governance**, which scrutinizes organizational frameworks to judge whether legal entities and individuals make appropriate, sustainable decisions.

**Table 1:** Sample ESG Factors[10,11]

| Environmental | Social | Governance |
|---|---|---|
| Air and water pollution | Community relations | Audit/board structure |
| Biodiversity | Customer satisfaction | Board independence |
| Carbon emissions | Data privacy and security | Bribery and corruption |
| Climate change | Employee engagement | Fair competition |
| Deforestation | Gender and diversity | Fair tax and accounting |
| Ecosystem integrity | Health and safety | Shareholder rights |
| Energy efficiency | Human rights and labor practices | Transparency |
| Natural resource management | | Whistleblower programs |
| Waste management | | |

7. OECD, June 2007, "The UN Principles for responsible investment and the OECD guidelines for multinational enterprises: Complementarities and distinctive contributions", p.2, https://www.oecd.org/investment/mne/38783873.pdf
8. Daniela Chimisso dos Santos, November 2021, "What is ESG", ACAMS Canada Conference
9. Ballard Spahr LLC., October 20, 2021, "ESG, AML compliance, and the convergence of social concerns", https://www.jdsupra.com/legalnews/esg-aml-compliance-and-the-convergence-8905564/
10. RBC Global Asset Management, 2021, "Our approach to responsible investments.", p.3, https://institutional.rbcgam.com/documents/en/common/article/approach-to-responsible-investment.pdf?language_id=1
11. Daniela Chimisso dos Santos, "What is ESG," op. cit.

## 3.3 Sources for Principles and Standards[12]

ESG has a growing base of literature that incorporates disclosures, investing, litigation, performance, reporting, and ratings. The literature has been accumulating for over five decades.[13] In 2021, over 120 companies, including Accenture, Bank of America, ENI, Fidelity International, and HSBC Holdings, committed to adopting an ESG framework around financial disclosures on four pillars focused on governance, people, planet, and prosperity.[14]

Metrics have been a common way to gradually move organizations to embrace the ESG reporting pillars, but few financial institutions have connected their ESG frameworks to financial crime.

Prevalent ESG guidelines and principles include:

- The Equator Principles – 10 principles for ESG risk management framework[15]
- G20 Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) Recommendations[16]
- Green Bond Principles – the guidance handbook provides principles and guidelines[17]
- International Labor Organization's (ILO) Core Conventions – eight conventions aimed at social and governance issues[18]
- Paris Agreement Capital Transition Assessment (PACTA)
- Principles for Responsible Banking[19]
- Poseidon Principles – an industry group aimed at international shipping[20]
- RE100 – a climate initiative to accelerate change[21]
- Roundtable on Sustainable Palm Oil (RSPO)
- United for Wildlife Financial Taskforce
- United Nations Environment Programme
- United Nations Global Compact Principles
- United Nations Guiding Principles on Business and Human Rights
- United Nations Universal Declaration of Human Rights
- Wolfsberg Principles – a source of anti-financial crime best practices

12. Citigroup, March 2021, "Environmental and social policy framework", pp.7-8, **https://www.citigroup.com/citi/sustainability/data/Environmental-and-Social-Policy-Framework.pdf**
13. Searches were run in EBSCOhost and ProQuest using a variety of terms
14. World Economic Forum, September 21, 2021, "Measuring stakeholder capitalism towards common metrics and consistent reporting of sustainable value creation", **https://www.weforum.org/our-impact/stakeholder-capitalism-50-companies-adopt-esg-reporting-metrics/**
15. Equator Principles, 2020, "The equator principles", **https://equator-principles.com/app/uploads/The-Equator-Principles_EP4_July2020.pdf**
16. Task Force on Climate-Related Financial Disclosures, **https://www.fsb-tcfd.org/about/**
17. ICMA, 2014, "The green bond principles", **https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/**
18. International Labour Organization, 2021, "Conventions and recommendations", **https://www.ilo.org/global/standards/introduction-to-international-labour-standards/conventions-and-recommendations/lang--en/index.htm**
19. United Nations, 2021, "Principles for responsible banking", **https://www.unepfi.org/banking/bankingprinciples/**
20. Poseidon Principles, 2021, "A global framework for responsible ship finance", **https://www.poseidonprinciples.org/finance/wp-content/uploads/2019/07/Poseidon_Principles.pdf**
21. RE100 Climate Group, 2020, "Annual progress and insights report 2020", **https://www.there100.org/growing-renewable-power-companies-seizing-leadership-opportunities**

## 3.4 Linking ESG and AFC

ESG has become very popular in the financial and investment management sectors. As a result, financial institutions invest substantial money and time into frameworks, reporting, and disclaimers. Likewise, financial institutions have invested significant resources into AFC and sanctions programs. So, it is curious that the financial industry has not married ESG and AFC objectives into one comprehensive framework to fight financial crime and promote sustainable finance.

The purpose and rationale for linking ESG with AFC activities is a natural synergy to reduce overlapping monitoring and reporting activities into a centralized framework, and ultimately balance significant business opportunities tied to ESG with strong financial crime risk detection and mitigation activities. The data of both actions are consumed by internal and external parties to enhance an organization's shared value, which Michael Porter and Mark Kramer espoused. Shared value is a pivot concept that enhances a company's competitiveness while simultaneously advancing the economic and social conditions in the communities in which it operates.[22]

Moreover, ESG and AFC are vital areas for regulatory oversight. Regulators in the UK and the US have a keen interest in promulgating best practices. As such, the effort to link ESG and AFC activities would enhance accountability, transparency, and governance. Boards are increasingly held accountable for the corporation that they run.

22. Michael Porter & Michael Kramer, Harvard Business Review, January-February 2011, "Creating shared value", **https://hbr.org/2011/01/the-big-idea-creating-shared-value**

# 4. Case Studies

## 4.1 Financial Flows

The financial sector, and the resulting financial flows, continue to be an indispensable tool for regulators, shareholders, and various stakeholders. Subsequently, internal controls are a source for encouraging or restricting financial flows into the global economy. This paper illustrates that ESG and AFC activities are similar mechanisms to address environmental, social, and governance decisions and outcomes.

Post COP26, ESG is becoming a lightning rod for environmental and social action. As financial institutions look to increase ESG-related businesses, reviewing or enhancing AFC controls that account for supply chain risk and associated financial crime indicators can ensure ESG growth is not lucrative for criminal actors. Similar to other financial crime risks, criminal activity can mimic expected trade and transactional patterns.

A vital area currently lagging on ESG action is the corporate board; certainly the uneven regulatory interest could create legal regimes that vary from country-to-country, which may impede change and elevate concerns about the impact on long-term performance.[23]

## 4.2 Case Example One: Lithium Mining and the Taliban[24]

Why do you need a financial crime lens on your ESG activities? Because the quest to become sustainable should not allow financial crime to flourish. In early 2010, the Pentagon identified that Afghanistan was the "Saudi Arabia of lithium".[25] Lithium is a critical component for electric vehicle batteries; large Fortune 500 companies need lithium to run their products. So, the decision to acquire lithium from Afghanistan becomes a difficult choice.

**Figure 1:** lithium mining (source: Shutterstock)

23. Tensie Whelan, Harvard Business Review, January 18, 2021, "Boards Are Obstructing ESG – at Their Own Peril", **https://hbr.org/2021/01/boards-are-obstructing-esg-at-their-own-peril**
24. Julia Horowitz, CNN Business, August 19, 2021, "The Taliban are sitting on $1 trillion worth of minerals the world desperately needs", **https://www.cnn.com/2021/08/18/business/afghanistan-lithium-rare-earths-mining/index.html**
25. James Risen, New York Times, June 13, 2010, "U.S. Identifies Vast Mineral Riches in Afghanistan", **https://www.nytimes.com/2010/06/14/world/asia/14minerals.html**

## 4.3 Case Example Two: Deforestation and Illegal Logging of Rosewood[26]

Deforestation is a crucial concern for ESG stakeholders. The loss of tropical rainforest means there are fewer trees for $CO_2$ capture. However, many hardwood species, such as rosewood, are harvested for their inherent properties. On January 2, 2017, the entire Dalbergia genus (known as various rosewood) was banned from importation/exportation without proper permits and documentation by the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), with some species banned prior.[27] However, loggers and their intermediaries harvest restricted timber across Africa to be shipped worldwide for furniture and other items. Smugglers attempt to evade customs with false documentation, or bribe and corrupt government employees. In 2017, Singapore convicted Wong Wee Keong of importing rosewood from Madagascar in violation of CITES.[28] The high profits from illegal timber along with low conviction rates encourage criminal behavior.[29]

**Figure 2:** legal rosewood logging in Mayinga, Zambia, 2019 (source: WWF) © Jasper Doest / WWF

26. World Wildlife Crime Report, 2020, "Rosewood Timber", **https://www.unodc.org/documents/data-and-analysis/wildlife/2020/WWLC20_Chapter_2_Rosewood.pdf**
27. Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), October 5, 2018, "Consideration of proposals for amendment of appendices I and II", **https://cites.org/sites/default/files/eng/cop/17/prop/060216/E-CoP17-Prop-57.pdf**
28. Edward Carver, Mongabay, April 26, 2017, "Singapore convicts rosewood trader in historic CITES seizure", **https://news.mongabay.com/2017/04/singapore-convicts-rosewood-trader-in-historic-cites-seizure**/
29. Selina Lum, The Strait Times, April 8, 2019, "Rosewood case: Court of Appeal clears businessman and firm of importing logs without a permit", **https://www.straitstimes.com/singapore/courts-crime/rosewood-case-court-of-appeal-clears-businessman-and-firm-of-importing-logs**

## 4.4 Case Example Three: Illegal Gold Mining

Another example is illegal gold mining in Peru, which destroys fragile ecosystems leading to progressive deforestation and pollution.[30] In the past three decades, local artisanal gold mining has consumed 250,000 acres from the Peruvian Amazon (as shown in the pictures between May 31, 2020, and May 2, 2021).[31] More artisanal miners strip the countryside of its resources as gold prices rise, increasing destruction. Drug syndicates further encourage this activity to mask the exchange of value to launder the proceeds of crime, as highlighted in an Organization of American States (OAS) report.[32]

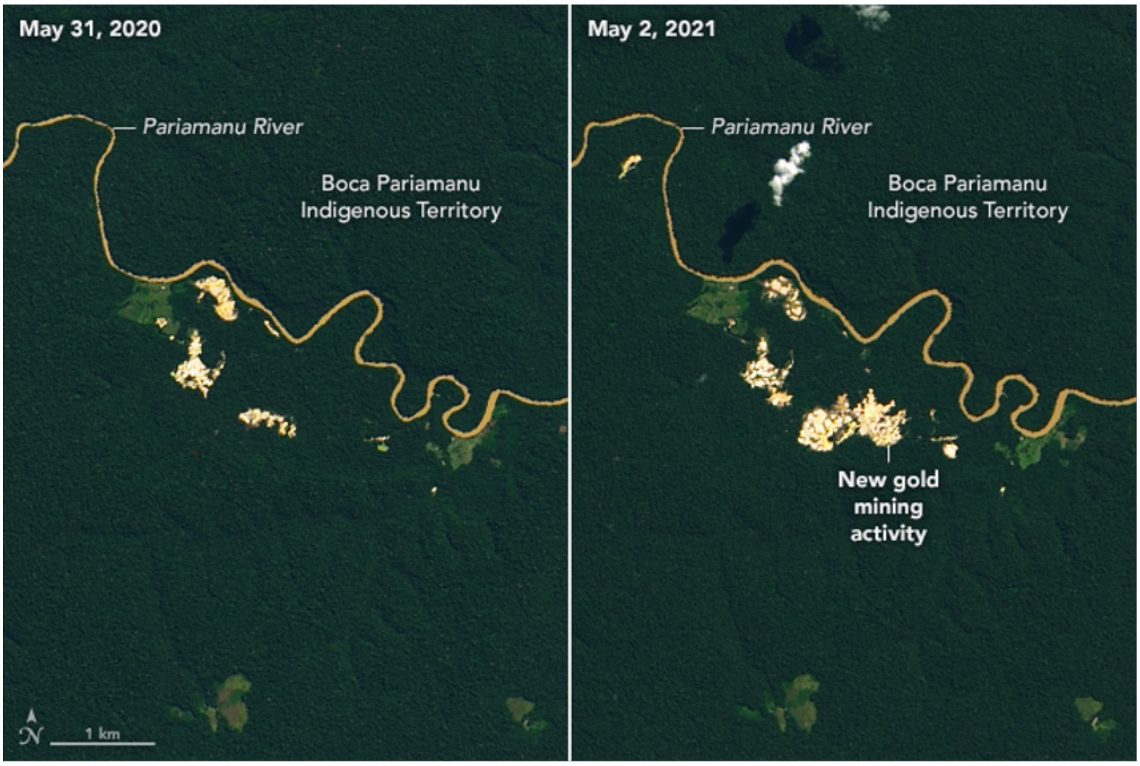


**Figure 3:** Satellite pictures of the Peruvian Amazon (source: NASA)

Yet, Peru is not alone. Illegal gold mining is happening across the Indo-Pacific, Africa, and South America. This activity has concerned FATF, who commented in 2021 that the financial flows from precious metals and stones continued to be a rising concern underpinning environmental crime.[33] Moreover, transnational criminal organizations are attracted to these crimes because of the high rewards and low levels of enforcement and penalties.

30. USAID, December 3, 2021, "Illegal gold mining", https://www.usaid.gov/peru/our-work/illegal-gold-mining
31. NASA Earth Observatory, June 16, 2021, "Finding Gold Mining Hotspots in Peru", https://earthobservatory.nasa.gov/images/148439/finding-gold-mining-hotspots-in-peru
32. Organization of American States, December 31, 2021, "On the trail of illicit gold proceeds: Strengthening the fight against illegal mining finances", p.29, https://www.oas.org/en/sms/dtoc/docs/On-the-trail-of-illicit-gold-proceeds-Peru-case.pdf
33. FATF, July 2021, "Money Laundering from Environmental Crime", pp.13-14, https://www.fatf-gafi.org/publications/environmentalcrime/environmental-crime.html?hf=10&b=0&s=desc(fatf_releasedate

# 5. The Direction of Travel – Mapping Sustainable Development Goals to AFC Typologies

The **United Nations has outlined seventeen sustainable development goals** (SDGs). It should not be a surprise that many financial predicate crimes and typologies have a tangible effect on more than just SDG 16 ("Peace, Justice, and Strong Institutions"). In figure 4, ACAMS has connected the 17 SDGs to existing predicate crimes. The list is not exhaustive, but representative of how financial institutions may overlay financial crime compliance with their ESG exercise to gain broader momentum.

While SDG 16.4 specifically targets reducing illicit financial and arms flows, a casual observer can find that multiple AFC typologies spread across various SDGs. For example, poverty is often associated with violent crime and drug dealing. Modern slavery and human trafficking have ties to gender equality. Illegal waste dumping has a link to clean water and sanitation. Illegal logging and land clearing link with climate action. The table demonstrates that crime, in various forms, can undermine our environment, civil society, and the well-being of individuals because of excessive profits.

**Potential financial areas and types of products to examine:**

- Commercial and corporate lending
- Project financing, lending, and refinance
- Government loans and advisories
- Export/import/trade finance
- Acquisition finance
- Debt securities, bond underwriting, and investing
- Equity securities, underwriting, and investing
- Letters of credit, bid bonds, and performance bonds
- Private banking and advisory

**Types of AFC issues to consider:**

- Adult entertainment (because of its relationship to sex trafficking)
- Arms and military equipment manufacturing
- Business in conflict areas, high-risk jurisdictions, or protected areas
- Child sexual abuse materials (CSAM)
- Child labor

**Types of AFC issues to consider (cont.):**

- Energy areas: coal and fossil fuel extraction
- Human rights abuses
- Human trafficking
- Illegal wildlife trade
- Illegal logging of deforested areas
- Illegal land clearing or development
- Illegal or unreported fishing
- Illegal waste dumping or pollution
- Modern slavery
- Pollution and improper waste management (such as carbon emissions)


**Figure 4:** SDG table with financial crime typologies

# 6. Recommendations and Conclusions

## 6.1 Siloed Thinking

An AFC compliance program incorporates a variety of areas, including anti-money laundering (AML), counter-terrorist financing (CTF), sanctions, anti-bribery and corruption (ABC) mitigation, and fraud controls into a comprehensive financial crime prevention framework. The framework deters and prevents criminal activity, often leading to exiting clients for non-compliance or excessive risk.

On the other hand, ESG is a popular method for conducting investment analysis and re-directing investment flows. Moreover, ESG is not simply a framework for investors and portfolio managers, but also a decision-making tool for boards and senior managers to prioritize development, track investment flows, and report progress. As a result, the annual reports of many financial institutions include ESG-related goals, disclaimers, and measures.

Few organizations connect those themes with high-risk customer and product areas that are negatively impacted by corruption, modern slavery, or broader ecological problems. FATF estimates that environmental crime generates “around US$110 to 281 billion in criminal gains each year”.[34] In 2018, FATF estimated that forced labor contributed US$51.2 billion and sexual exploitation US$99 billion.[35] The United Nation’s Sustainable Development Goal 16 aims to reduce illicit financial flows and improve asset recovery by 2030.[36]

Financial institutions should evaluate how they can weave their AFC processes into their ESG framework and governance processes. This approach has helped some financial institutions improve their ESG ratings. Apart from the obvious synergies in utilizing existing detection and mitigation techniques, board and senior management would better align strategy goals, policies, risk appetite statements, risk assessments, and detection processes.

## 6.2 Trends

The financial sector recognizes its mounting role in addressing climate change, creating a sustainable strategy, and encouraging economies, businesses, and customers to transition. The industry also has a role in identifying bad actors and criminals that exploit and prey on vulnerable areas. The industry’s current responsibilities aim to detect suspicious activity and provide beneficial information to law enforcement; however, they can strengthen a firm’s ESG commitments and initiative.

For some, this action translates to a low-carbon footprint, and for others, it is about changes in internal and customer behaviors on consumption and production. Depending on the organization and jurisdiction, the path forward may include anything from wholesale changes to business operations, to minor corrections.

34. FATF, “Money Laundering from Environmental Crimes”, op. cit.
35. FATF - APG, July 2018, “Financial Flows from Human Trafficking”, pp.13-14, **https://www.fatf-gafi.org/media/fatf/content/images/Human-Trafficking-2018.pdf**
36. United Nations, January 2022, “SDG 16.4 Indicators”, **https://unstats.un.org/sdgs/metadata/?Text=&Goal=&Target=16.4**

### Example One: Scotiabank

Scotiabank's approach aggregates activities into these four pillars: Environmental Action, Economic Resilience, Inclusive Society, and Leadership & Governance.[37] Through these filters, customers, products and services, and their engagement with wider stakeholders are evaluated for sustainability and ESG qualities. In addition, Scotiabank highlights fighting financial crime as part of their ESG responsibilities.[38]

### Example Two: JPMorgan Chase

JPMorgan Chase's approach is integrated into their business decision-making. The strategy outlines commitments, disclosures, risk management, and governance processes. In addition, JPMorgan Chase has policies that outline principles, identification areas, prohibited activities, escalation mechanisms, and areas of surveillance of transactions.[39]

### Example Three: Citigroup

Citigroup approaches ESG by recognizing issues, such as supporting the environment and human rights, and requiring policies and mitigation plans throughout the organization's operations, supply chain, and inspection of client transactions.[40] Citi created an Environmental and Social Risk Management (ESRM) Policy to analyze and track their progress. Operational goals include reducing greenhouse gas emissions and waste, energy, and water consumption, and creating sustainable buildings.[41] Moreover, the framework outlines a strategy intertwined with the firm's commitments on risk appetite and risk management policies to prohibit or restrict high-risk industries and consumer segments (i.e. military equipment, nuclear power, palm oil).

### Example Four: HSBC

HBSC espouses becoming a net-zero bank, highlighting an ambition to reduce direct and indirect emissions by 2030.[42] The company reports progress by jurisdiction, global business, and financing commitment.[43] In addition, HSBC has created an internal task force to monitor progress and provide disclosures and updates.

37. Scotiabank, (n.d.), "ESG Strategy", **https://www.scotiabank.com/ca/en/about/responsibility-impact/esg-strategy.html**
38. Ibid., "leadership & governance"
39. JPMorgan Chase & Co., October 8, 2021, "Environmental and social policy framework", pp.3-5, **https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/documents/environmental-and-social-policy-framework.pdf**
40. Citigroup, March 2021, "Environmental and social policy framework", **https://www.citigroup.com/citi/sustainability/data/Environmental-and-Social-Policy-Framework.pdf**
41. Ibid., p.7
42. HSBC Holdings Plc., 2021, "Annual report and accounts 2020", p.45, **https://www.hsbc.com/who-we-are/esg-and-responsible-business**
43. HSBC Holdings Plc., 2021, "ESG data pack 2020", p.45, **https://www.hsbc.com/who-we-are/esg-and-responsible-business**

## 6.3 Recommendations

Financial institutions should design AFC programs with ESG goals in mind. The board of directors should encourage senior management to address environmental, social, and governance objectives in their AFC policies, risk appetite statements, and reporting systems. ACAMS recommends five core activities:

1. **Develop** an organizational AFC strategy infused with ESG objectives
2. **Design** risk appetite statements (zero risk limits on destructive activities)
3. **Integrate** ESG into your AFC enterprise risk assessment
4. **Define** metrics
5. **Manage** ESG risk(s) with monitoring and reporting

#### Impact on Strategy

Financial institutions may want to develop their ESG strategy considering their AFC framework. Many financial crime risk management frameworks already incorporate risk management and AFC techniques, such as designating sensitive customer groups. These customer groups include:

- Casinos and gaming companies (including internet gaming)
- Coal and consumable fuels
- Environmental and facilities services
- Furniture manufacturers
- Firearms, munitions, and military equipment
- Gas and water utilities
- Marine activities, ports, services
- Oil and gas exploration, drilling, and production
- Paper products (which use hardwoods)
- Precious metals and minerals
- Tobacco farming and manufacturing

#### Updating Policies and Risk Appetite

Firms should examine their internal policies to include prohibitions and restrictions that align ESG with AFC. Such statements prohibit commercial activities with entities or individuals involved, or suspected to be involved, in modern slavery, human and child trafficking, environmental crimes, or munition. ESG activities may create exemptions or conditions where action may be encouraged, such as investment in planting activities to re-forest damaged areas or helping a company realign business activity away from a destructive activity.

Examples of zero risk appetite:

- No investment in conflict areas or areas of elevated risk due to human rights risks or where sanctions have been applied
- No business activities or relationships with entities or individuals involved in modern slavery, including various forms of forced labor or human trafficking
- No commercial activity or production or trade in illegal logging or transfer of timber from vulnerable areas or protected species
- No commercial activity or production or trade in wildlife or products regulated under CITES
- No business relationship or commercial investment where companies are involved with unsustainable fishing practices, such as drift net fishing in the marine environment using nets above 2.5km in length
- No equity or debt investments where a company or their subsidiaries manufacture, transfer, or are involved in the movement of cluster munitions

A common practice is to highlight areas of zero risk or limited risk appetite for investing, lending, commercial activity, or management of the supply chain. In addition, many financial institutions may prompt risk review, due diligence, or risk assessment before the business commits any money.

Examples of restricted risk appetite:

- A critical review of project financing loans or corporate lending in sensitive jurisdictions, areas, or industries (more significant than US$10 million)
- Restricting business and commercial activity in countries where corruption is deemed endemic (where Transparency International's Corruption Perception Index is below a score of 26)
- Investment, lending, or payment flows where an entity's revenue is less than 25% from coal or non-renewable resources

**Evaluating the Enterprise-Wide Risk Assessment**

The risk-based approach requires that financial institutions have systems and controls that correlate to the specific risks of AML/CTF and sanctions that they face. As a result, financial institutions need to allocate more resources to the highest risk areas. The Equator Principle 2 recommends an environmental and social assessment where areas are classified Category A (adverse impact), Category B (limited negative impact), or Category C (no effect)[44] - an approach similar to the high, medium, and low AFC approach.

As many AFC and sanctions practitioners know, the enterprise-wide risk assessment is critical for identifying, managing, and deterring suspicious activity within an organization's operational jurisdictions, customer base, product suite, and platform channels (as well as for projects). The risk assessment is necessary for senior management to identify gaps, make an informed decision on risk appetite and residual risk, adjust the business and operations, and build essential internal controls to align to the inherent dangers and resulting environment.

44. Equator Principles, June 2013, "Equator principles", p.5, https://www.equator-principles.com/app/uploads/The_Equator_Principles_III_June2013.pdf

Regulators compel reporting entities and their boards to manage risk prudently, in which the risk assessment is an essential tool for communicating risk internally and externally.

Enterprise-wide risk assessment pulls data from subsidiaries and branches into an aggregated view, which may be in higher-risk jurisdictions or areas. FinCEN and the US State Department recently identified six countries (Cambodia, Cameroon, Democratic Republic of the Congo, Laos, Madagascar, and Nigeria) on the IWT Concern List.[45,46]

Vulnerable industries may need to be examined within customer groups, supply chains, or suppliers. Vulnerable sectors are shown in table 2 by standardized industrial classification (SIC) or North American Industry Classification system (NAICS) codes to help identification. The reader should note that SIC codes can be converted to international standard industry classifications (ISIC).

**Table 2:** Fama and French Sin Portfolio[47]

| Industry | Code | Classification Number |
|---|---|---|
| **Alcohol** | SIC | 2100 – 2199 |
| | NAICS | 325193, 4248, 42481, 424810, 42482,424820, 7224, 72241, 722410 |
| **Tobacco** | SIC | 2080-2085 |
| | NAICS | 424940, 453991, 11191, 111910, 312, 3122, 31221, 3212210, 3122, 312221, 312229 |
| **Gambling** | SIC | 7132, 71312, 713120, 71329, 713290, 72112, 721120 |
| **Military** | SIC | 3760-3769, 3795, 3480-3489 |
| | NAICS | 3336992 |
| **Firearms** | SIC | 3482, 3484 |
| | NAICS | 332992-332994 |
| **Oil** | SIC | 1300, 1310-1339, 1370-1382, 1389, 2900-2912, 2990-2999 |
| **Biotech** | SIC | 3240-3241 |

As ESG concerns have widened beyond alcohol, tobacco, gambling, and firearms, additional industries and codes have been added, including:

- Forestry: SIC code 0851
- Fisheries: SIC codes 0912-0913 (NAICS 114111-114112)
- Massage parlors: SIC codes 7299
- Metal mining: SIC code 1081
- Medicine (including traditional Chinese medicine): SIC codes 0742 and 2833 (NAICS 541940)
- Mining (coal): SIC code 1221
- Musical instruments: SIC codes 3931 and 5736 (NAICS 339992)
- Nail/beauty salons: SIC code 7231 (NAICs 812113)

45. US Department of State, November 4, 2021, “2021 END Wildlife Trafficking Report”, p.5, **https://www.state.gov/2021-end-wildlife-trafficking-report/**
46. FinCEN, December 20, 2021, “Financial threat analysis: Illicit finance threat involving wildlife trafficking and related trends in Bank Secrecy data”, p.9, **https://www.fincen.gov/sites/default/files/2021-12/Financial_Threat_Analysis_IWT_FINAL%20508_122021.pdf**
47. Hoje Jo, Journal of Business Ethics, November 2012, “Does CSR Reduce Firm Risk? Evidence from Controversial Industry Sectors”, **https://www.researchgate.net/publication/257541900_Does_CSR_Reduce_Firm_Risk_Evidence_from_Controversial_Industry_Sectors**

- Pet stores and supplies: SIC code 5999 (NAICS 453910)
- Petroleum production: SIC code 1311
- Zoos: SIC codes 7999 and 8422 (NAICS 71213, 712130, & 712190)

An ESG framework evaluates inherent risk similarly, by declaring unacceptable areas, such as prohibitions on arms manufacturers or additional restrictions, due diligence requirements, or investment restrictions. A place of opportunity is to re-define the risk based approach to become a value-weighted tool for adjusting jurisdictions, customers, products, and channels.

**Monitoring and Reporting**

An essential element of ESG is identifying and measuring progress against key performance indicators (KPIs) and key risk indicators (KRIs). These KPIs and KRIs are typically embedded into strategy, balanced scorecards, and risk appetite statements. For example, some financial institutions may track the energy use per facility and aggregated level and calculate greenhouse emissions or waste creation. Other firms may follow the investment into ESG activities or penalties for ESG shortfalls.

Numerous groups and task forces have begun publishing information on metrics and targets. One such group is the Task Force on Climate-Related Financial Disclosures (TCFD) which has published several papers on types of financial disclosures.[48,49] The guidance refers to identifying financed amounts to company and asset classes with high emissions, the amount of purchase of carbon credits, percentage of revenue from coal mining, utilities using coal, or concentration of credit exposure to a particular jurisdiction or industry.

Sample indicators:

- Number of clients in ESG vulnerable sectors
- Aggregated dollar value (absolute US$ sum of transactions received of the transaction to a high-risk jurisdiction or industry)
- Percentage of transactions flows to a high-risk ESG jurisdiction or industry
- Percentage number of customers (# vs total customer base) in an ESG vulnerable sector
- Percentage number of suspicious activity reports (SARs)/suspicious transaction reports (STRs) from ESG vulnerable customers, industries, or countries (versus the total number of SARs/STRs)

Unfortunately, there are no consistent ESG/AFC metrics across the financial industry. As a result, various industry groups are developing strategies and transition plans.

48. TCFD, June 2021, "Proposed guidance on climate-related metrics, targets, and transition plans", **https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf**
49. TCFD, October 2021, "Guidance on metrics, targets, and transition plans", **https://www.fsb.org/wp-content/uploads/P141021-2.pdf**

## 6.4 Conclusions

Even beyond SDG 16.4, financial institutions should be attempting to reduce illicit financial flows from financial crime. Moreover, this paper highlights how the financial sector can extend the underlying ESG concept with existing AFC activities to enhance sustainable activities. Several risk factors are shared between ESG and AFC domains, enabling risk managers to streamline risk identifications, reporting, and mitigation. Subsequently, risk professionals working on ESG risk identification can utilize the existing AFC enterprise-wide risk assessment. Senior leadership may recognize synergies between the two efforts.

The outcomes associated with ESG are not significantly distinct from AFC, both aim to protect and position a financial institution for long term success. There are new opportunities for AFC professionals to utilize financial intelligence and enhance risk strategies, policies, risk appetite statements, monitoring, and reporting to drive success. ACAMS intends to improve the dialogue with the financial community about the linkages between ESG and AFC in our conferences, webinars, and other engagements.

# About ACAMS

ACAMS is the largest global membership organization for anti-financial crime professionals, with 89,000+ members in over 180 countries/regions. We support individuals and organizations dedicated to ending financial crime through thought leadership, continuing professional education, and our best-in-class peer network.

ACAMS offers two specialist-level certifications; **CAMS**, which is recognized as the gold standard in AML certifications by institutions, governments, and regulators worldwide, and **CGSS**, the global program for equipping professionals with the tools they need to understand and interpret changing sanctions regimes.

ACAMS has also launched a series of **social impact certificates**, designed to identify transactional activity linked to the illegal wildlife trade, modern slavery, and human trafficking. All of our social impact certificates are offered free of charge to our global community as part of our mission to end financial crime.

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# Authors and Contributors

## Author

William Scott Grob, CAMS-FCI, CGSS, Director of Research & Analysis, ACAMS

## Contributors

- Joseph Mari, CAMS, Scotiabank
- Patrick Dutton, HSBC
- Emiko Matsuda, WWF Japan