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COMPLIMENTARY WEBINAR

How a robust Financial Crime Risk Management Framework can support your Environmental, Social and Governance (ESG) Program

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Mr. Frank Morisano

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Mr. Frank Morisano is an internationally recognized executive and acclaimed storyteller who has developed a unique style of combining highly emotional stories and strong visual artistry with emerging technologies. He has over 30 years of proven financial services accomplishments: globally growing businesses, steering profitable growth in new markets, guiding product development, leading the acquisition, divestment and restructuring of companies, promoting risk proficiency in companies, and implementing ESG standards, frameworks, and disclosure reporting software to comply with global regulatory requirements.

Previously, he was the Chief Risk Officer of the largest bank in the world with responsibility for the Americas risk profile, strategic planning, governance, consolidated enterprise risk management, BSA/AML, sustainable finance, compliance, credit risk management, liquidity, crisis management, fraud and operational resilience. He also established their compliant cybersecurity framework and activities as the Chief Information Security Officer as well as the ESG disclosure reporting.

Prior roles include the leadership of revenue generating businesses at PwC, GMAC, JPMorganChase, and Bank of America. He serves on private and public boards as a non-executive and independent director, where he is a member of the Audit, Risk, and Strategy committees and is known for establishing and implementing effective Board governance. He speaks regularly on ESG, Technology, and Cybersecurity.

Anti-money laundering and Sustainability

Convergence

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 Environment, Social, and Governance (ESG) frameworks.

Both anti financial crime (AFC) and ESG programs aim to improve the quality of financial flows. Together they ensure and protect a financial institutions revenue quality while also focusing on rising social responsibility to save our planet.

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Defining ESG

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

- **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

Sample ESG Factors

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		

Poll Question #1

Why should Financial Institution Compliance and Risk professionals care about ESG?

- ❑ High profitability of ESG crimes?
- ❑ Better resourcing for sustainability initiatives?
- ❑ To avoid penalties from regulators?

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Why should you care about ESG

Awareness

Global estimates suggest that proceeds from criminal activities such as illegal logging, illicit wildlife trade and forced labor could be in the region of hundreds of billions dollars each year, making these activities some of the most lucrative sources of revenue for criminals.

On Sept. 25, 2023 money manager DWS Investment Management Americas Inc. (DWS), a subsidiary of Deutsche Bank AG, agreed to pay $25 million to resolve two investigations — one focused on environmental, social and governance-related misstatements and another that found shortcomings in anti-money laundering efforts.

Why should you care about ESG

Regulatory Focus

All economic activities face climate risk. This includes the financial services industry, both through physical impacts of environmental events (e.g. customers in affected sectors being unable to repay loans) and transition risks from moving to a lower carbon economy (e.g. litigation risk relating to financing activities).

In March 2021, the European Parliament put forward a draft directive on mandatory corporate due diligence and accountability, which would require all European companies, including financial institutions to identify and address adverse impacts on human rights, the environment and good governance in their value chain.

Principles and Standards

Prevalent ESG guidelines and principles include:

- The Equator Principles – 10 principles for ESG risk management framework
- G20 Financial Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) Recommendations
- Green Bond Principles – the guidance handbook provides principles and guidelines
- International Labor Organization's (ILO) Core Conventions – 8 conventions aimed at social and governance issues
- Paris Agreement Capital Transition Assessment (PACTA)
- Principles for Responsible Banking
- Poseidon Principles – an industry group aimed at international shipping
- RE100 – a climate initiative to accelerate change
- 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

Why should you care about ESG

Reputation risk

The negative perception of a financial institution business partnerships and resulting reputational damage is no less important than the risk of regulatory enforcement or legal liability that may arise from perceived or alleged neglect.

Activist investors are moving money away from firms with poor records, while consumer campaigns boycott products with unethical sourcing in their supply chains. ESG failures put companies and their third parties in the spotlight with negative press and social media commentary, leading to a loss of consumer confidence and revenue.

Why should you care about ESG

Social Risks

The field of ‘Social and human capital’ is grounded in the principle that natural capital, social capital, human capital and produced capital form the foundation of human wellbeing and economic success. By understanding how they impact and depend on the capitals, companies are supported to make holistic decisions that create value for nature, people and society alongside businesses and the economy.

Business should evaluate the change in outcomes for affected people that result from business actions aimed at addressing negative impacts on human rights.

Poll Question #2

Can an ESG and AFC program be interwoven?

- ❑ Yes
- ❑ No

Customer Due Diligence (CDD)

Broadening the scope

The principles that underpin customer onboarding requirements for assessing financial crime can be rapidly adapted to support key risk indicators for ESG.

Information gathering: existing procedures such as the desktop research and customer outreach performed by KYC analysts can be used to collect and process data on ESG.

Independent verification: the KYC process can be a resource to independently verify information provided as part of customers' voluntary ESG disclosures.

Risk assessment: incorporate an ESG component into their existing customer risk rating process

Case Studies

Failure to develop the appropriate AML program

On September 25, the U.S. Securities and Exchange Commission (SEC) announced a US$19 million settlement with the investment adviser DWS Investment Management Americas Inc. (DIMA) for material misstatements and shortcomings in its policies and procedures related to Environmental, Social and Governance (ESG) investing.

The SEC focused on lack of: (1) training, (2) testing, (3) controls, (4) standards for management, (5) consistency in approach, and (6) remediation once it recognized the inconsistencies.

Key Takeaways

No bold statements. Institutions need to ensure that such statements are supported in practice.

Appropriate policies, procedures, and controls to prevent ESG-related misstatements as well as provide clear expectations to analysts and enabling supervisors and compliance teams to tell whether analysts are adhering to guidance.

Compliance teams should be adequately staffed and have appropriate authority to safeguard reports

Case Studies

Precious metals and stones

In the past three decades, local artisanal gold mining has consumed 250,000 acres from the Peruvian Amazon

Drug syndicates further encourage this activity to mask the exchange of value to launder the proceeds of crime

Key Takeaways

Underpins financial crime activities. Institutions need to ensure that they are doing effective KYC onboarding and understanding the beneficial owners in the entire supply chain

Compliance teams should be adequately staffed and have appropriate authority to safeguard reports

Key considerations for success

Broadening the scope

Understanding the customer's approach to ESG: Implement a standardized ESG questionnaire to identify any materials risks as part of the CDD process to understand their customers ESG practices and how they manage social and environmental risks

Include the right risk indicators: Adopt a set of ESG specific risk indicators by assigning risk scores to industry sectors based on their potential exposure to unsustainable environmental practices or forced labor; taken into account in the customer risk calculation methodology

Adopting a risk-based approach: implement a process to assign an ESG risk score to customers, and flag those with identified ESG risk triggers during the course of the CDD review.

Looking beyond: Recent cases of forced labor allegations and enforcement actions globally illustrate that ESG issues often do not take place within the focal entity, but in its supply chain. Consider subsidiaries and major suppliers in the supply chain.

Reframe your ESG perspective

If you're not uncomfortable, you're not doing it right

Executing an authentic ESG strategy entails more than making donations and disclosures. It means reexamining and rethinking the value drivers of the business.

Those financial institutions with the courage to embrace the discomfort by rethinking their assumptions, tackling the intractable issues, and telling their story even when it's imperfect are the companies that will be well-tuned to thrive in the era of stakeholder capitalism.

Design AFC programs with ESG goals in mind:

- Develop the institutions AFC strategy infused with ESG objectives
- Include specific ESG risk appetite statements (zero risk limits on destructive activities)
- Integrate ESG into the AFC enterprise risk assessment
- Define ESG metrics and indicators
- Manage ESG risk(s) with monitoring and reporting

AFC Topologies

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

AFC Topologies

Potential 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
- Energy areas: coal and fossil fuel extraction
- Human rights abuses and 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)

Questions?

Thank You