



Governance Brief

International Cooperation Against Financial Backers of Illegal Logging

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1. International Finance and Timber Trading

International financial institutions have taken part in financing timber extraction in Indonesia. They included Credit Suisse First Boston, ING Bank N.V., and Credit Lyonnais of Singapore (Setiono, 2005). By 1999 four Dutch banks; ABN-AMRO Bank, ING Bank, Rabobank, and Mees Pierson, had invested in 740,000 ha of oil palm plantations in Indonesia (Wakker, 2000). Since the early 1990s, international financial institutions have played a critical role in facilitating the rapid expansion of the Indonesian pulp and paper industries. They were responsible for channeling over US\$12 billion into these industries by 1999 (Barr, 2001).

International financial institutions serving Malaysian and Singaporean timber trading companies should be aware of risks involving illegal timber trading. Many reports have suggested the involvement of businessmen or financial backers from Malaysia and Singapore in illegal logging activities in Indonesia. The dominant role of Malaysian financial backers in illegal logging activities is apparent in Indonesia's West Kalimantan province. There are three gateways for illegal Indonesian logs to enter Sarawak Malaysia; these are the harbors of Entikong, Badau, and Sematan. In 2002, 354,816 m³ of illegal logs were transported via Entikong, another 360,866 m³ passed through Badau, while a further 372,168 m³ passed through Sematan Harbor (Budiarto, 2003) and (Alqadrie et al, 2002).

2. International Capacity to Curb Illegal Logging

Fighting forestry crime, particularly illegal logging, has become a growing international concern over the past five years.¹ Several initiatives have been introduced to develop international cooperation against forestry crime. These include the Forest, Law Enforcement, and Governance (FLEG) initiatives in Asia and Africa, the Asia Forest Partnership (AFP) sponsored by the Japanese and Indonesian governments, the European Commission Action Plan on FLEGT and the proposed FLEG in Latin America.

International cooperation against forestry crime should benefit from international collaboration against money laundering. In the 1989 G-7 Summit in Paris, the Financial Action Task Force (FATF) on money laundering was created to guide and promote national and international policies for combating money laundering and preventing the financing of terrorism. The FATF is a multidisciplinary body, which meets several times a year bringing together the policy-making power of legal, financial, and law enforcement experts.

Some international initiatives have been introduced recently for using the anti-money laundering regime to stop forestry crime. The European Union has led the initiative in Europe to criminalize illegal logging so that its proceeds can be subject to money laundering legislation (Marijnissen, 2003). In a more promising initiative, in its 2004 typology workshop in Brunei Darussalam, the Asia/Pacific Group (APG) on money laundering agreed to form a working group on illegal logging



and money laundering in response to a motion put forward by the Indonesian Reporting and Financial Transaction Analysis Centre (PPATK) and the World Bank. The APG is a regional cooperative group of Pacific and Asian countries working together to combat money laundering. APG member countries include the United States, China, Japan, Singapore, Malaysia, Indonesia and Australia.

In support of the FATF, the Basel Committee on Banking Supervision, an international forum of the world's central banks, issued guidelines for preventing banks from being used by criminals. The capacity of criminals to launder the proceeds of their crimes through the banking system can threaten financial stability both nationally and internationally. The Basel Committee on Banking Supervision issued the Basel Core Principles to improve the strength of financial systems. One of the important Core Principles is to protect banks from being used by criminals by requiring banking supervisors to determine they have adequate policies, practices and procedures in place, including strict 'Know Your Customer' (KYC) rules. This principle requires banks to have adequate policies, practices, and procedures for preventing and detecting criminal activity or fraud, and for reporting any suspected activities to the appropriate authorities. This principle supports international cooperation against money laundering.

3. Financial Community Intervention

The FATF and the Basel Committee on Banking Supervision could force financial authorities

that control the accounts of financial backers of illegal logging to freeze their accounts. Preventing illegal loggers from benefiting from the proceeds of their illegal logging activities should reduce the incentives for illegal logging. The capacity to freeze the accounts of the financial backers will also help with the investigation and prosecution of those involved in illegal logging and other forestry and environmental crimes.

FATF

The FATF could issue a special recommendation or policy on illegal logging. The recommendation should encourage member countries to criminalize financial backers of illegal logging and the illegal timber trade.

When countries have already criminalized financial backers of illegal logging, there are at least two channels by which countries could freeze financial backers' accounts. The first channel, an informal but effective one, involves membership in the Egmont Group. The FATF recommends that all countries create Financial Intelligence Units (FIUs) to serve as national centers for receiving (and, as permitted, requesting), analyses and disseminations of STR and other information regarding potential money laundering or terrorist financing.² Since 1995, a number of FIUs across the world have begun working together in an informal organization known as the Egmont Group (named after the location of the first meeting in the Egmont-Arenberg Palace in Brussels). The aim of the group is to provide a forum for FIUs to improve support for their national anti money laundering programs. This support includes expanding and systematizing the exchange of financial intelligence, improving the expertise and capacity of FIU personnel, and fostering better communication among FIUs through the application of new technologies.

The second channel for pursuing proceeds of crimes abroad involves setting up mutual legal assistance (MLA) with the countries where the proceeds of crimes are transferred, deposited, or invested. This mutual legal assistance could include collecting evidence and statements from people; providing evidence in the form of documents and other notes; identifying and locating individuals; executing search and seizure warrants; tracing, freezing, and sequestering the proceeds of crimes; or obtaining agreements from persons to testify or provide assistance to investigations.

The Basel Committee on Banking Supervision

In support of the FATF, the Basel Committee on Banking Supervision should issue a special recommendation on prudential requirements relating to high-risk sectors such as the forestry sector and the public sector in developing countries where corrupt practices are widespread. One key policy on the prudential requirements is the implementation of the 'Know Your Customer' (KYC) principles. The Basel Committee should request bank supervisors to monitor banks' implementation of KYC principles for forestry related transactions. Many major international and local banks are financing pulp and paper industries as well as timber industries.

The Basel Committee, through the Core Principles Liaison Group including the International Monetary Fund (IMF) and the World Bank, could enforce its recommendation through assessment of the implementation of the Core Principles of Banking Supervision by bank supervisors across the world. The Core Principles were developed to provide the international financial community with a benchmark against which the effectiveness of bank supervisory regimes could be assessed. The need for strengthening supervision of banks is being stressed as a major priority since it is now widely recognized that weaknesses in banking systems have been at the core of financial crises in many countries over the past decade (Basel 1999).

The IMF and the World Bank could play an active role in the implementation of the Core Principles. The IMF could influence its member countries to comply with a special recommendation of high-risk sectors in the context of its surveillance mandate. The World Bank too could encourage its clients to adopt a special recommendation on high-risk sectors in the course of its regular operations.

4. Challenges and Recommendations

Given the extensive international news coverage on illegal logging and comprehensive international cooperation to combat money laundering crimes in the region, one would expect banks to have begun reporting suspicious financial transactions involving their forestry related customers in Indonesia, Singapore, and Malaysia. Deviations in the normal transaction patterns of customers, and media and NGO reports should have made banks aware of the illegal forestry activities of their customers. However, at the time of writing, only two reports have been submitted to the Indonesian



Photo by Hari Priyadi

Reporting and Financial Transaction Analysis Centre (PPATK) relating to suspicious financial transactions in the forestry sector. One possible reason for this anomaly is the fact that banks regard most forestry related customers as prime customers because they bring significant business and profits to the banks. The Indonesian timber industry is an important player in the economy with export earnings totaling more than US\$6 billion annually.

International cooperation against illegal logging should now shift to international collaboration against the financial backers of illegal logging and other forestry crimes. The international money-laundering regime could help freeze the accounts of financial backers of illegal logging wherever they keep their accounts in the international financial system, something that could never be achieved using forestry legislation alone.

Policy Recommendations:

1. The Basel Committee on Banking Supervision should issue a special recommendation on prudent requirements and KYC principles relating to the financial backers of illegal logging and other forestry crimes.
2. The Basel Committee should encourage banking supervisors in Japan, China, Singapore, Malaysia, USA, and Europe to audit the implementation of KYC principles and the AML law by banks that are significantly involved in the plywood, sawn timber, pulp and paper, oil palm, and mining industries.

3. At this stage, international cooperation to use anti money laundering laws for fighting forestry crime has just begun. It is encouraging that the Asia Pacific Group (APG) on money laundering considers illegal logging to be as serious an offence as drug trafficking or terrorism. In collaboration with international initiatives against forestry crimes such as FLEGT, the FATF should support the APG in creating working groups to study illegal logging and in developing measures to combat it. The FATF should also issue a special recommendation or policy regarding forestry and environmental crime.

Reference

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Footnotes

¹ See details on the history of growing international concern over forestry crimes in the International Forestry Review Vol. 5 (3), September 2003, *Special Issues: Illegal Logging*.

² FATF Recommendation No. 26



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