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Workshop title: Follow the Money to Curb Forest Crimes
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Global challenge:

Role of commercial banks in combating forestry corruption in South East Asia;

Role of banks to monitor the flows of money;

To act as reporting parties for suspicious transactions related to forest business.

1. Commercial banks have a role in stemming targeted crimes. That role is not optional. It is legally mandated.

The potential utility of anti-money laundering and counter-terrorism financing (AML/CTF) systems for addressing forestry offences and corruption offences (Sharman & Chaikin 2009[i]; Levi, Dakolias, & Greenberg 2007[ii]) is an idea discussed in the last few years and is arguably a key AML/CTF concern for countries in the South East Asian region (Dorn & Levi 2007[iii]).

AML/CTF regimes have become largely a universal phenomenon in the last decade and commercial banks are central components of those regimes. The systems are structured to require banks and other regulated businesses to capture financial intelligence and disseminate it to law enforcement and regulatory agencies. AML/CTF does not only offer an opportunity for banks to facilitate efforts to combat financially motivated crimes: banks are legally mandated to perform this function.

The core tenets require banks to identify all customers that they transact with; to identify customers posing higher risks of money laundering and gather additional information from those customers; to monitor their transactions and retain this information; and identify and report anything suspicious to authorities. Each requirement provides information useful to uncover and investigate forestry corruption offences.

Indonesia's AML/CTF system is an illustration of a South East Asian country with a legal structure that requires its commercial banks to assist law enforcement to stem forestry corruption; I will consider how to make it more effective.

2. **A South East Asian case study: Indonesian Anti-money laundering and counter-terrorism financing. Commercial banks are involved by Indonesia's criminal provisions; in freezing assets; and by the preventative legislation.**

Money laundering is a criminal offence in Indonesia under the Law concerning the Crime of Money Laundering (as amended by Law Number 25 Year 2003) (Law 15/2002). There are three key aspects of the Indonesian AML/CTF regime that amplify the commercial banks' role in stemming forestry corruption. The first is the inclusion of bribery, corruption, and almost all of Indonesia's forestry offences as predicate crimes for money laundering (Law 15/2002 Article 2). This means that funds tied to any of these three offences may lead to a money laundering charge; and any transactions a commercial bank suspects are connected to these offences should become the subject of a suspect transaction report.

The second element is the commercial banks' integral role in tracking and freezing illicit assets tied to forestry corruption. Law 15/2002 Article 32 permits an investigator, public prosecutor or judge to direct a financial services provider to freeze assets known or suspected to be the proceeds of crime. Law 15/2002 defines the proceeds of crime as those generated by the list of predicate offences contained in the Act or any offence with a penalty of 4 years imprisonment or more. Bribery, corruption, and most forestry crimes fall within this definition. Assets controlled by a suspect, defendant or individual reported to the investigator by the Indonesian financial intelligence unit may be frozen and the burden of proof lies with the individual to demonstrate the assets in question are not the proceeds of crime (Article 35). The assets are seized if sufficient evidence is obtained in a hearing (Article 34).

Law 31/1999 (Articles 18-19) specifically allows property connected to a corruption offence, or used to commit a corruption offence, to be confiscated; corruption defendants also hold the burden of proof to demonstrate that their personal wealth was not generated by corruption (Article 38B of Law Number 20 of 2001 on Changes in Law Number 31/1999).

The third element is the personal liability of executives of a company found to be engaged in money laundering offences. The maximum fine available increases by one third where a company is convicted of a money laundering offence. The company may also receive additional penalties such as having its business license revoked (Law 15/2002 Article 4).

3. **Commercial banks gather, record, and report financial intelligence. Financial intelligence assists investigations, prosecutions, and asset recoveries from crimes**

Indonesia's AML/CTF preventative regime outlines a complimentary set of mechanisms that involve commercial banks in the prevention, investigation, and prosecution of forestry corruption. The key regulatory mechanisms are customer identification; enhanced due diligence for higher risk customers and transactions; requirements for politically exposed persons (PEPs); ongoing transaction monitoring; record keeping; and reporting suspect transactions, cash transactions, and international funds transfers. Each requirement generates information that may be used to investigate forestry corruption offences.

The contribution of commercial banks to curbing forestry crimes and related corruption offences is a legal requirement established by Law 15/2002 and expanded by Bank Indonesia's enforceable instruments.

4. **The key elements that can curb forestry corruption are customer identification; enhanced due diligence for higher risks; politically exposed persons; ongoing transaction monitoring; financial intelligence reporting.**

Law 15/2002 compels all financial institutions to identify their customers and it compels their customers to comply with the company's identification procedures. Commercial banks are required to establish whether a customer is acting on their own behalf or on behalf of another and to establish the identity of the other party (Law 15/2002 Article 17). The identification procedure for individuals must include their name, address, age, religion, and occupation to satisfy the minimum requirements (APGML 2008[iv]). Bank Indonesia requires commercial banks to ascertain the source and purpose of the funds presented to the bank (Bank Indonesia Regulation 3/10/2001). The minimum identification requirements for small companies also include identifying the source and purpose of any funds presented; large companies must supply this information as well as financial statements and the company's management structure. The income information collected for individuals, small companies, and large companies, allows commercial banks to identify businesses and individuals posing greater risks of engaging in forestry corruption by means of their contact with the industry.

Commercial banks are required to establish policies for identifying high risk customers, transactions, and countries; and to nominate an officer for dealing with high risk transactions (Bank Indonesia Circular Letter 5/32/2003). Commercial banks are to determine whether customers carry a higher risk of engaging in illicit transactions by considering their backgrounds, nationality, business activities, and position. The enhanced due diligence steps might include documenting the higher risk customer's employer's identity. The identification information, outlined above, requires banks to know which of their customers are in contact with the forestry sector; this requirement obligates banks to

identify high risk transactions within that sector. The requirements, together, direct commercial banks to closely monitor at-risk transactions but this depends on the bank's assessment of the risks posed by actors connected to the forestry sector.

PEPs are designated as high risk customers that require enhanced due diligence in Indonesia (Bank Indonesia Regulation 3/10/PBI/2001). Bank Indonesia defines PEPs as Indonesian or foreign national public officers holding executive, legislative, judiciary, or state administration roles; companies owned or run by public officers; and their immediate family members and close associates. Bank Indonesia's PEP requirements mean that high ranking officials already warrant enhanced screening. This leaves only the potential risks associated with lower ranked officials as those where the risk level is determined and managed at the discretion of commercial banks.

The transaction monitoring systems required by Bank Indonesia direct commercial banks to maintain profiles for their customers. The key profile requirements are the identity information, occupation or line of business, total income, all accounts held, normal transaction activity, and the purpose for opening the account (Circular Letter No. 5/32/DPNP). The transaction monitoring system requirement removes some of the discretion noted above: customer profiling that focuses on total income and business activities is well placed to identify those outside of the PEP-requirements that pose higher risks of making or receiving payments tied to forestry corruption.

Commercial banks in Indonesia are legally obligated to monitor all of their transactions and report those that are incompatible with a customer's profile, or are otherwise suspicious, to PPATK, the Indonesian financial intelligence unit, within three business days. Law 15/2002 provides financial service providers with a definition of suspect transactions that cover a) transactions outside of the profile, characteristics or usual patterns of a customer; b) transactions reasonably suspected to be structured to prevent triggering the reporting requirements of the financial service provider; or c) transactions reasonably suspected to be attempted or performed with the proceeds of crime (Article 1). PPATK 's guidelines for identifying a suspicious transaction cover large cash transactions; funds transfer instructions to high risk countries or multiple small denomination transfers to a single account; and customers that seek to circumvent the reporting or identification requirements (PPATK 2003[v]).

5. Improving performance and aiding compliance

The Asia/Pacific Group on Money Laundering suggest that compliance with the AML/CTF regulations is not uniform across banks in Indonesia. The bulk of suspect transaction reports are lodged by four state owned banks (PPATK 2009[vi]; APG 2008a[vii]). Bank Indonesia

issued around 2,800 fines and warnings for noncompliance with the requirements to banks between 2005 and 2007[viii]. It is hard to gauge the impact that these sanctions have had on compliance rates but compliance might also be maximised by a range of measures beyond sanctions issued by the regulator.

Best practise strategies aim to maximise the AML/CTF compliance of commercial banks and other regulated businesses. Legislators and regulators in other countries, such as Hong Kong (FATF-GAFI 2008[ix]), have offered specific examples of high risk transactions that banks and other reporting entities might consider closely. Transactions that the Asia/Pacific Group (2008b[x]) suggests warrant further attention are:

- Unexplained wealth of forestry officials evidenced by purchases or transactions disproportionate to their stated total income.
- Transactions connected to timber businesses (such as logging, shipping and processing) made to or from high risk countries, such as those without legal forestry industries;
- False or suspicious statements on bank documents, customs, and other documents associated with the timber industry;
- Any connections or transactions between PEPs, lower level forestry officials, military, or law enforcement officers and timber brokers, forestry officials, concession holders, timber processing companies, shippers, exporters customs officials, or financial institutions.

The Indonesian requirement for banks to document the occupation and total income of all customers helps banks to identify transactions posing a higher risk of being tied to forestry corruption, even where the customers are not PEPs.

Government employees in logging regions (for example forestry officials, local police, and customs officials) that warrant additional scrutiny from commercial banks to ensure the legitimacy of their transactions might include those:

- With total incomes disproportionate to expected incomes from generic customer profiles;
- With assets or transactions disproportionate to their stated total incomes;
- Receiving funds from any company involved in timber extraction or in the timber processing industry; and
- Remitting funds to Malaysia, Hong Kong, or Singapore; or receiving funds from Malaysia, particularly Malaysian Borneo.

The red flags for timber companies warranting closer examination might include:

- Timber companies with accounts or transactions in excess of the stated income or incompatible with the supplied financial statements
- Receiving or remitting funds outside of a harvesting pattern;
- Receiving or remitting funds to or from Malaysia;

- Transacting with Indonesian government employees or Malaysian government employees; and
- Transacting with government departments, such as district forestry departments, outside of an established permit cycle.

Other strategies to maximise effective compliance are:

- Compiling, maintaining, and disseminating to commercial banks, a list of domestic PEPs. Australian regulated businesses from some sectors flagged identifying PEPs as problematic (Australian Institute of Criminology n.d[xi]). Uruguay is an example of country that provides this information to businesses (Rijock 2009[xii]).
- Providing feedback on suspect transaction reports, such as outcomes on reported transactions, and feedback on the quality of information provided by the bank, such as the system in Hong Kong (FATF-GAFI 2008).
- Education and other outreach programs to maintain contact with reporting businesses.

[i] Sharman J & Chaikin D 2009.Corruption and anti-money laundering systems: Putting a luxury good to work. Governance 22 (1): 27-45.

[ii] Levi M, Dakolias M & Greenberg T 2007. Money laundering and corruption, in Campos JE & Pradham S (eds), The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level. Washington: World Bank

[iii] Dorn N & Levi M 2007. East meets west in anti-money laundering and anti-terrorist finance: Policy dialogue and differentiation on security, the timber trade and 'alternative' banking. Asian Criminology 3: 91–110

[iv] Asia-Pacific Group on Money Laundering (APGML) 2008a. APG Second Mutual Evaluation Report on Indonesia against the 40 Recommendations (2003) and 9 Special Recommendations. Sydney: APGML

[v] Pusat Pelaporan Dan Analisis Transaksi Keuangan (PPATK) 2003. Guidelines on the identification of suspicious financial transactions for financial dealers. Jakarta: PPATK

[vi] Pusat Pelaporan Dan Analisis Transaksi Keuangan (PPATK) 2009. Statistic of Suspicious Transaction Reports (STRs), Cash Transaction Reports (CTRs) per 31 December, 2008. [30 September 2010] http://www.ppatk.go.id/statistik_eng.php?nid=22

[vii] Asia-Pacific Group on Money Laundering (APGML) 2008a. APG Second Mutual Evaluation Report on Indonesia against the 40 Recommendations (2003) and 9 Special Recommendations. Sydney: APGML

[viii] Asia-Pacific Group on Money Laundering (APGML) 2008a. APG Second Mutual Evaluation Report on Indonesia against the 40 Recommendations (2003) and 9 Special Recommendations. Sydney: APGML

[ix] Financial Action Task Force (FATF-GAFI) 2008. Third mutual evaluation report anti-money laundering and combating the financing of terrorism: Hong Kong, China. Paris: FATF-GAFI/OECD

[x] Asia-Pacific Group on Money Laundering (APGML) 2008b. APG typologies report 2008. Sydney: APGML

[xi] Australian Institute of Criminology (forthcoming). Anti-money laundering first tranche study. Canberra: Australian Institute of Criminology

[xii] Rijock K 2009. Central Bank of Uruguay publishes "Official" PEP List. *A Different Angle 17 February*. World-Check website. http://www.world-check.com/articles/2009/02/17/central-bank-uruguay-publishes-official-pep-list/