The war against money-laundering is being lost

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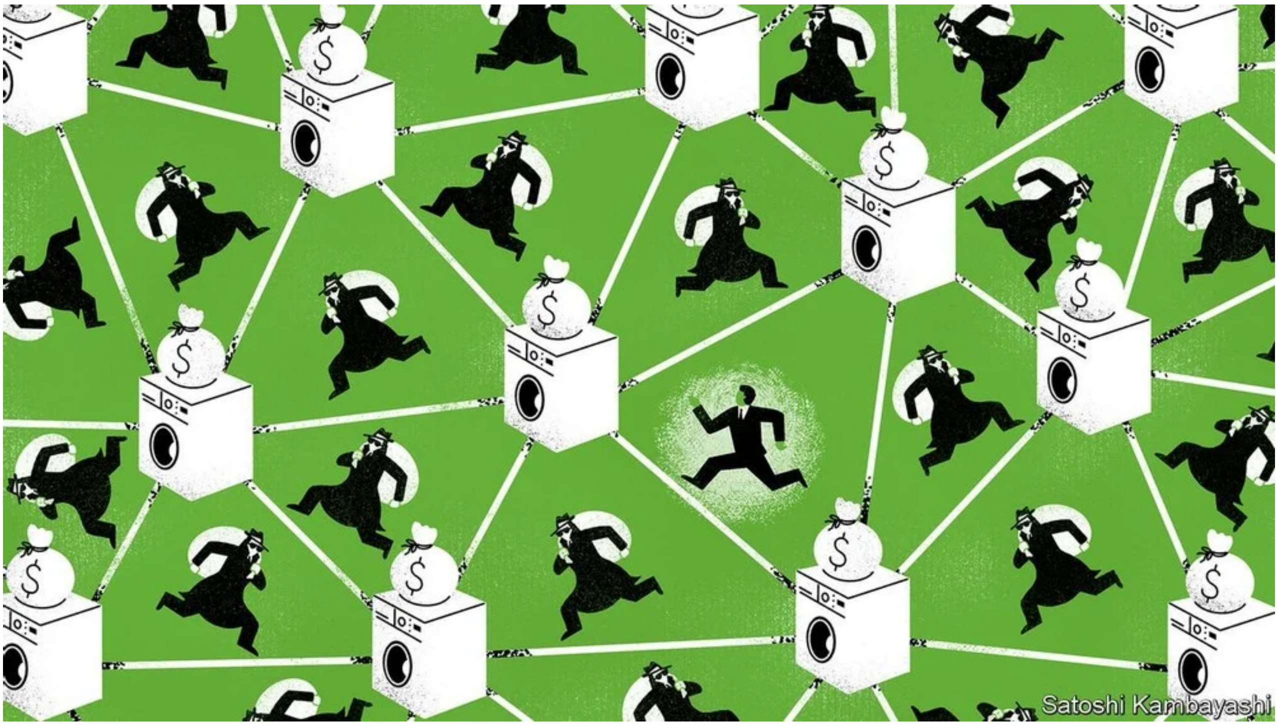

Losing the war

The global system for financial crime is hugely expensive and largely ineffective

Finance & economics

YET ANOTHER bank is preparing to face the music over alleged failings in its efforts to curb flows of dirty money. In the coming weeks NatWest, one of Britain's largest lenders, is set to appear in court in London to respond to charges that it failed to properly scrutinise a gold-dealing client that deposited £365m ($502m) with the bank—£264m of it in cash.

NatWest (which has said it is co-operating with the investigation) is the latest in a long line of banks to be accused of falling short in the fight against dirty money. Last year global lenders were hit with $10.4bn in penalties for money-laundering violations, an increase of more than 80% on 2019, according to Fenergo, a compliance-software firm. In January Capital One, an American bank, was fined $390m for failing to report thousands of suspicious transactions. Danske Bank is still dealing with the fallout of a scandal that erupted in 2018. Over $200bn of potentially dirty money was washed through the Danish lender's small Estonian branch while executives missed or ignored a sea of red flags.

These cases suggest that banks remain the Achilles heel in the global war on money-laundering, despite the reams of regulations aimed at turning them into frontline soldiers in that conflict. However, closer examination suggests that the global anti-money-laundering (AML) system has serious structural flaws, largely because governments have outsourced to the private sector much of the policing they should have been doing themselves. A study published last year by Ronald Pol, a financial-crime expert, concluded that the global AML system could be "the world's least effective policy experiment", and that compliance costs for banks and other businesses could be more than 100 times higher than the amount of laundered loot seized.

Red-tape revolution

Money-laundering was not even a crime across much of the world until the 1980s. Since then countries from Afghanistan to Zambia have been arm-twisted, particularly by America, into passing laws. This effort intensified after the 9/11 terrorist attacks in 2001 and the passage of America's Patriot Act, which targeted the money trails of those financing terrorists and other criminals.

This has turned AML compliance into a huge part of what banks do and created large new bureaucracies. It is not unusual for firms such as HSBC or JPMorgan Chase to have 3,000-5,000 specialists focused on fighting financial crime, and more than 20,000 overall in risk and compliance.

The AML push has succeeded in stamping out the most pernicious practices, such as using shell banks (those with no real customers) in sunny places to launder suitcases stuffed with drug money. But criminals haven't been forced to get particularly creative: it is not much more difficult today than it was 20 years ago to rinse dirty money by setting up a shell company, disguising the loot flowing through it as legitimate revenue and persuading an established bank to process it.

As a result, the numbers tell of a war being lost. The "Global Threat Assessment", a report by John Cusack, an ex-chair of the Wolfsberg Group, an association of banks that helps develop AML standards, estimates that $5.8trn-worth of financial crime was perpetrated in 2018—equivalent to 6.7% of global GDP. Statistics on how much is intercepted by authorities are patchy. A decade-old estimate by the United Nations Office on Drugs and Crime put it at just 0.2% of the total. In 2016 Europol estimated the confiscation rate in Europe to be a higher but still paltry 1.1%.

Some experts think the success rate may have fallen in recent years, in part because of the rise of "trade-based money-laundering"—which moves dodgy money into the legitimate economy by playing tricks with paperwork for cross-border trade. The covid-19 pandemic, too, has boosted opportunities for financial ne'er-do-wells. Criminals have set up shell companies to exploit vast, poorly policed government-aid schemes. In Britain, the authorities have received more than 50,000 reports of potential misuse of its "Bounce Back Loans" and furlough schemes.

The Financial Action Task Force (FATF), the intergovernmental body that sets global AML standards, admits to problems with the system. Last October its president, Marcus Pleyer, sounded an exasperated note, accusing the "vast majority" of countries of failing to tackle money-laundering. Some countries have been able to achieve solid marks in the organisation's assessments by passing nice-looking AML laws, only to water them down later, or fail to implement key provisions. One offender is the United Arab Emirates, where weak enforcement has helped Dubai become a haven for corrupt capital. But America and Britain also look to game the FATF process, albeit less egregiously.

Global efforts to stamp out money-laundering have, if anything, waned over the past five years, says Robert Barrington, a professor of anti-corruption practice at the University of Sussex. In 2016 David Cameron, Britain's then prime minister, hosted a global anti-corruption summit, and other governments queued up to back the cause. But it proved a false dawn. Britain became distracted by Brexit. In America, President Donald Trump showed scant leadership on the issue. Russia and China have stymied efforts to co-ordinate global anti-corruption efforts.

Three big problems hobble the fight against financial crime: a lack of transparency; a lack of collaboration; and a lack of resources. Start with transparency. Investigators can struggle to identify the real, "beneficial", owners of shell companies, who often hide behind legal nominees.

Some progress has been made in increasing visibility. Britain launched a public register of company owners in 2016, spurring several others to follow suit. Britain's offshore satellites, such as the British Virgin Islands and Jersey, have been arm-twisted into setting up registers or strengthening existing ones. Late last year American lawmakers passed a law requiring ownership data on firms registered at state level, including in Delaware's incorporation factories, to be held in a federal register.

However, many countries still eschew registers, and those that have them have encountered problems. In Britain, for instance, criminals have been willing to risk filing false information, or none at all, given the modest penalties for doing so. Hong Kong, meanwhile, plans to scale back the details company owners must disclose on its register.

The FATF is reviewing its standard on beneficial-ownership transparency with a view to making it tougher; the current version says merely that "competent authorities" should have access to such information "in a timely fashion". But getting its 39 core members—from America and the EU to China and Russia—to agree on a new text will be difficult.

The second problem, lack of collaboration, hobbles governments' work with each other, and with banks on the front line. The big money-laundering schemes are sophisticated and transnational, while anti-laundering efforts remain balkanised. Information-sharing between governments is improving, thanks to co-operation among "financial-intelligence units", national centres that collect data on suspicious transactions. But the "mutual legal assistance" system, which countries investigating crimes use to request information from each other, is clunky.

As for data flowing to and from banks, the benefits of sharing are indisputable. "The value of information coming from a network of banks is thousands of times higher than the information any one bank has, because you can see not just where the money came from, but where it went, and where it went from there, and so on. It gives you a picture of the network," says the head of a large international bank. Unfortunately, the level of collaboration is "terrible". America does best, thanks to the Patriot Act, but even there information-sharing is "on a tiny scale", with anything more requiring a warrant from a judge, "which is hard if you don't know what the crime is yet". Britain is in second place, he says, with "about 30%" of the data-sharing done in America. And in third place? "No one."

A daunting obstacle to sharing information is data-privacy laws, which in many countries prevent banks from passing information to authorities, particularly those in other countries. Some big banks have lobbied for exceptions to be made for AML, but "governments don't see it as a legislative priority", says an executive at another bank.

The third difficulty, a dearth of resources, stems from the fact that white-collar crime is less visible than violent crime. Spending on curbing the latter goes down better with the public. In Britain, fraud makes up more than a third of reported crime, yet gets less than 1% of police resources in terms of officers. Banks can spend all they like on AML, but the criminals won't end up in court if governments fail to invest in policing and prosecution.

Many crime-fighting agencies lack the funding to properly analyse the torrent of so-called "suspicious-activity reports" banks file when they spot potentially dodgy transactions. SARs are a cornerstone of the current system. But banks file too many low-quality or unnecessary reports because the system incentivises them to cover their backs rather than apply sensible risk criteria. Globally they file millions of SARs a year; in Britain alone regulators received over 573,000 in the 2019-20 financial year.

All this suggests that governments need to work harder collectively to make the AML system fit for purpose. "Blaming banks for not 'properly' implementing anti-money-laundering laws is a convenient fiction," Mr Pol's report concluded. It also gives an unfair pass to the non-bank actors that enable corruption. While fines for banks with poor AML controls have risen relentlessly, lawyers who set up dodgy shell companies, accountants who sign off on their fishy filings and the like have been getting away with slaps on the wrist. Britain's revenues and customs agency, for instance, supervises more than 30,000 accountants, estate agents and other businesses for money-laundering purposes; in the 2019-20 financial year it issued just 31 fines, averaging £290,000. Governments also need to get to grips with the AML implications of cryptocurrencies, and the firms and exchanges that hawk them. A recent report by the Bank for International Settlements warned of "a critical need for swift and global implementation of international standards".

Activists who campaign to fix the cracks in the global AML architecture are pinning much hope on the Biden administration, which has said that it views the fight against corruption as a national-security issue and therefore a priority. Whether it can work more profitably than its predecessor with Europe, which is overhauling AML oversight in the wake of the Danske debacle, remains to be seen. Hopes that China can be persuaded to co-operate are not high. Either way, bankers should probably brace themselves for another beating.