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THE CURRENT: What do leaked financial documents reveal about dirty money in banking?

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PITA: You're listening to The Current, part of the Brookings Podcast Network. I'm your host, Adrianna Pita.

On Monday, Buzzfeed and the International Consortium of Investigative Journalists released a report on their 16-month investigation into thousands of files obtained from the U.S. Treasury Department's Financial Crimes Enforcement Network, commonly called FinCen. The consortium's investigation revealed new insights into money laundering and other financial crimes throughout the global banking system.

With us to explain what's in these files and what we're learning about the extent of illicit money flows through major institutions is Matthew Collin, David M Rubenstein fellow here at Brookings in the Global Economy and Development department. Matt, thanks for talking to us today.

COLLIN: Thanks for having me today.

PITA: So, these files span nearly two decades, from about 1999 to 2017, so what what's in this trove of files?

COLLIN: I think before we talk about what's in the files, it's first important to understand what the files actually are and how they're generated. If you're a bank or another institution that handles money in the United States, whenever you see a transaction or client that you think shows some suspicion of laundering money or perhaps terrorist financing or any sort of financial crime, you're obligated to file what's called a suspicious activity report. This is a report that has some basic information on the transaction, who was involved, a little bit of narrative written by the bank's compliance officer. And it's sent through a secure filing system to FinCen -- that's the Financial Crimes Enforcement Network this this arm a treasury in charge of tracking down a lot of financial crime. These reports have been around for a long time since the early 1990s, but they've really Increased a lot, particularly since September 11 happened and after the Great Recession happened, FinCen has really leaned a lot on these reports for gleaning what's happening within the U.S. financial system.

Last year, institutions filed about 2.2 million of these reports to FinCen. The trove that journalists got their hands on is just a tiny sample of the total number that have been filed. About 12 million have been filed since 2011, and by most accounts, the files that journalists got their hands on, the ICIJ and Buzzfeed got their hands on, was about 2100 - 2200 SARS, the suspicious activity reports. It seems to be the case that these are not just a random selection. These are a set of reports that were cultivated, perhaps by FinCen, during the investigation into the 2016 Russian interference in our election, and maybe some reports that were put together because of requests from other law enforcement agencies. So, this is like a really cultivated set of reports that FinCen had its eyes on for a while and that appears to be what has leaked to the press. And it contains a lot of bad stuff. It contains details of large international banks hosting Ponzi schemes, of helping fiends of Vladimir Putin move money around to different tax havens, it's got connections to organized crime, has got connections to terrorist financing, there's a whole slew of negative stories that are coming out about what is contained in the files.

PITA: Okay, so these files, these are the reports the bank's reporting, as they are supposed to, suspicious transactions and or clients to the appropriate U.S. federal enforcement agency. So what's in the consortium's findings? Are these failures of reporting or what sort of in sort of information required to be reported? Is this failure of follow-up, of enforcement? What were their findings that were so explosive?

COLLIN: So, one thing to note first, is that the very existence of these reports means that some parts of the reporting system are working correctly, that as opposed to previous leaks, like the Panama Papers, where we got some insight into the money that banks were moving around in their own systems, these are suspicious activities that's actually being reported to the authorities as banks are required to do. So, in some sense, things are working. When the friend of Vladimir Putin was moving money around, banks were reporting that to FinCen.

I think one of the things that has come out of the reporting is just the sheer scale of some of these schemes. We're talking billions and billions of dollars.

Another thing that's come out, is the fact that banks are supposed to file a suspicious activity report within 30 days of noticing that activity, and it seems to be the case that banks often did that, but there are many cases where banks really didn't notice what their clients were up to, until, in some cases, years after the fact. It was only when journalists began reporting on corrupt public officials and other actors who were found to be conducting money laundering and stealing public funds, it’s only when these people entered the public limelight that banks began to notice that these same people were their clients and then began reporting much later than you would have wanted them to. So, in some sense, the system is moving a lot slower than you'd want it to.

The other thing that that jumped out of the reports is that, ideally you would detect someone laundering some cash, you'd report it to FinCen and the authorities would identify that it was an illicit transfer and the police sirens would start wailing and people would show up and arrest the bad guys and that would be the end of the story. But what \ the journalists found is that in many cases, these were banks reporting on a client. Then reporting on a client again a year later. And then again, another year later. Multiple reports were being sent out about potentially suspicious dealings and nothing seemed to be happening very quickly about it. And part of that is because we don't observe the other side of the communication. We see what banks are telling regulators but we’re not actually seeing what regulators are telling banks back. So, it's not clear if regulators continued to monitor these accounts, if they actually just didn't notice and didn't have time to follow up. So, one thing that's highlighted is that that follow-up process may be not working as well as expected.

One of the reasons that might be the case is that FinCen deals with over a million and a half reports, just from banks every single year. There has been a real explosion in reports in the last two decades, but not a huge change in the number of people working at Fincen that have to sift through these reports. I looked at the numbers the other day and saw that for every FinCen employee, they get about 4000 reports a year from banks alone, not counting other types of institutions. And so that's a lot of paperwork for people to go through and find which of these reports are actually suspicious.

On the flip side, banks will get in trouble if they don't report on a client and later on the client is found, through other means is found to be laundering money. If that happens, they face large fines from regulators, they face a lot of public shaming. But if they file a report on somebody and then it turns out they were laundering money, they're in less trouble. And if they file a report on somebody that turns out to be a false positive, it turns out there wasn't actually anything to the transaction, they don't get in any trouble at all. So, banks face enormous incentives to file a lot. Anytime they get any whiff of a suspicious transaction, they'll file, leaving it up to FinCen to wade through that huge pile of reports and figure out what's actually really indicative of money laundering and what isn't. And so, part of the story that's coming out of these leaks is also the fact that organizations like FinCen are maybe overwhelmed with information. And unless we find a way to sort of improve the accuracy of the reporting system, it's going to be very hard for them to accurately follow up and accurately track down the worst cases.

PITA: So, what do you think is most important for people to understand about this? It seems like there are really major banks included in this; it sounds like from what you're saying the reporting and the regulatory system is somewhat overwhelmed by this. There's obviously a lot for people to dig into, so what are some of the most important takeaways here?

COLLIN: One of the big takeaways is actually something that's being discussed a lot in the press, and that is, there's been a huge change in the regulatory effort to try and stamp down on money laundering the last two decades. It's been one of the biggest regulatory shifts in human history in terms of fighting money laundering. And despite that, within the last 10 years you had all these schemes being run through banks with seemingly very little being done about it, at least very little being done quickly. So, one thing to note is just that it's still pretty bad. The same banks that you and I use for paying our bills and for saving for retirement are being used by a lot of corrupt and criminal organizations.

The second thing to take away, I think, is the fact that if we really want to start making our financial system a bit cleaner, making it less susceptible to this type of behavior, we have to invest in the regulatory agencies who are in charge of doing that. So FinCen probably needs a lot more funding than it currently gets. By my calculations FinCen's budget this year was less than the latest Jumanji movie: it was about 120 million dollars. It's not a lot of money for roughly 300 people who have to wade through millions and millions of reports every day. So, we need to put our money where our concerns are.

There are also a lot of different ways that the U.S., despite the fact that it's supposed to be the leader on anti-money laundering activity – it's the one that's often setting the agenda – we're clearly falling behind in many ways, not only in terms of following up on these reports, but our banking secrecy laws are not up to modern standard. It's very easy to hide money in the United States and prevent foreign governments from finding out about it. We don't share information with other governments as much as other governments are forced to share information with us. So, the last thing to take away is perhaps the fact that if we want our financial system to host less dirty money, we really need to start not only investing our institutions, but also start passing laws to make it harder for people to hide money here.

PITA: As we look ahead from this, we've seen bank stocks take a hit this week as this news has come out, but has there been any talk yet, any word from regulators and policymakers about what their possible responses might be?

COLLIN: So, there were initially some rumblings from regulators. FinCen issued a statement the other week, noting that just leaking these suspicious activity reports is itself a crime. This was highly sensitive information; you can't obtain a suspicious activity report through a subpoena, you can't obtain it through a freedom of information request. So, these are highly, highly sensitive information and its very leaking might damage the relationship between FinCen and the banks because the banks pass on this information with understanding that it will remain a secret. I think in anticipation that this was going to happen, last week FinCen issued basically some proposed changes to future regulation to start making it a bit easier to crack down on illicit finance. One of the things it focused on was on finding ways to make banks provide more useful information to authorities. As I mentioned earlier, banks seem to be reporting a lot of information, mainly because they have incentive to do so, but it’s not always very useful information. Those 2 million reports that regulators receive every single year, a lot of those are just going to be not very useful reports. So FinCen wants to find ways to improve that reporting mechanism. They haven't been very clear on how they're going to do that. And it's not clear if they're going to do it by just releasing guidance to sort of nudge banks to think about ways of doing it better or if they're going to come up with actual penalties to reporting false information.

I think, to be honest, given the current political climate, we're probably not going to see a lot of movement on this in the next few months. Everyone's minds are tied up with the upcoming election and with the ongoing recession that's been created by the COVID pandemic. So, this is probably going be an issue we're going to be seeing more of next year, once we begin recovering from that. So, I think right now it's more a little bit of damage control, a little bit of signaling that this is something that there's going to be movement on, but that movement may not happen for a while.

PITA: Alright. Well, Matt, thanks very much for talking with us today about this.

COLLIN: Thanks so much.