

Event Note

The Huggard Consulting Group Event

The St Regis Hotel, Washington DC, United States of America

22 April 2026

‘Better Regulation for AML, Avoiding Unintended Consequences’

On 22 April 2026, The Huggard Consulting Group convened a distinguished panel of policymakers, legal experts and industry leaders at The St Regis Hotel in Washington DC. With more than 50 registrants from the banking, financial services sector, think tanks, academia, Congress and regulatory communities, the panel examined the effectiveness of the current Anti-Money Laundering (AML) regulatory regime. The participants heard contributions from a panel of speakers with extensive industry, regulatory and law enforcement experience: **Richard Meads**, Director of Business Decisions Limited; **Nicholas Anthony**, Policy Analyst, Center for Monetary and Financial Alternatives, Cato Institute; **Him Das**, Senior Managing Director and Counsel, K2 Integrity, and previously Acting Director, FinCEN; **Lester Joseph**, President of Joseph AML Consulting LLC, formerly Principal Deputy Chief and Acting Chief of the Department of Justice Money Laundering, Narcotics and Forfeiture Section; **William Fox**, retired managing Director and Global Head of Financial Crimes Risk at Bank of America, and former Director of FinCEN, and **Greg Baer**, President and Chief Executive Officer of the Bank Policy Institute, previously President of The Clearing House Association and Executive Vice President and General Counsel of the Clearing House Payments Company.

The panel was chaired by Joseph Huggard CEO, The Huggard Consulting Group.

Richard Meads, Director of Business Decisions Limited, made the keynote address.

Money laundering is a serious, global crime, and governments must take action to combat it. There is, however, widespread concern about the effectiveness, costs of compliance, and unintended consequences of the regulatory model, including the creation of new forms of criminal activity. These issues have been examined from a Better Regulation perspective. This is a novel approach that generates insights which will contribute to the on-going global debate about how to make AML regulatory regimes more effective.

Better Regulation is a governance philosophy. It aims to ensure that all forms of government intervention are effective, limit unintended consequences and establish legitimacy for the use of the powers of the State. This approach to law-making and enforcement has been adopted by governments throughout the OECD area, encompassing formal commitments in 1995, 2005 and 2012. It has been the approach taken by the USA since 1993 and has formed the basis for rule-making in the EU since 2003. It is a systemic approach that addresses difficult and uncomfortable questions, focuses on all stages of the policy cycle (law, regulation and enforcement) and brings new insights.

Better Regulation interventions have a number of common characteristics: intervention logic based on evidence; robust understanding of benefits, even if difficult to measure; awareness of behavioural change, in response to government action; rigorous understanding of costs, unintended consequences and externalities; and, recognition of the potential for new or additional harms, known as risk-risk outcomes. Within this context, the

most effective regulatory interventions tend to be outcomes-based (rather than focused on inputs and processes), technologically neutral, supportive of innovation and avoid market distortion.

There is a strong justification for the use of the powers of the State to combat money laundering. Interventions seek to prevent crime, combat terrorism, strengthen national security and protect the integrity of the banking system. Protection of stability and order are moral purposes for governments. Money laundering is a major problem. More than 2% of global GDP is laundered and circa 1-2% of US GDP. Money laundering is not a victimless crime. It enables very serious predicate crimes (fraud, drugs, human trafficking, extortion, sexual exploitation, corruption et al) as well as the financing of terrorism.

Anti-Money Laundering (AML) regulatory regimes have a number of objectives: (1) Reduce incentives to commit predicate crimes; (2) Facilitate recovery of the proceeds of crime; (3) Help prevent the evasion of sanctions; (4) Disrupt the financing of terrorism; (5) Protect the integrity of the wider financial system. Governments have powerful logic to use the powers of the state to achieve these goals, but interventions must be effective, minimise unintended costs and avoid creating opportunities for new types of crime.

Most national governments use a common AML regulatory model. Its origins lie in the US Bank Secrecy Act of 1970 and the actions of the Financial Action Task Force, an intergovernmental organisation, set up in 1989 to share a common approach to countering money laundering. It is an unusual regulatory model. Compliance and information gathering is outsourced to the private sector which is obligated to undertake extensive Know-Your-Customer (KYC) reviews of all clients and transactions, and then to report 'suspicious' activities (SAR reports) and major cash transfers (CTRs) to regulators. Compliance with mandatory obligations and processes is overseen by bank and AML supervisors. Non-compliance is punished by major financial penalties of up to USD 1 billion. The EU has, in general, also followed this approach.

The scope of AML regimes has expanded steadily in terms of: numbers of regulated entities; KYC and due diligence requirements; Enhanced Due Diligence; numbers of predicate crimes; scale and nature of mandatory internal processes; and requirements to monitor all customers and transactions. Many of these extensive obligations are prescriptive and dirigiste, and many focus on processes rather than outcomes. KYC obligations have been further complicated by the progressive introduction of subjective risk designation and risk categorisation: 'high risk', 'politically exposes persons', 'nature', 'behaviour' or 'reputation' of clients; 'unusual', 'complex' or 'new' transactions'. Subjectivity, and hence regulatory unpredictability, is further exacerbated by the opaque nature of bank supervision, one of the mechanisms used to ensure AML compliance.

The AML regulatory model has generated global compliance costs for financial institutions of more than USD 180 billion annually. For many banks, nearly 15% of staff are directly committed to AML compliance. There have also been major penalties for non-compliance. Between 2014 and 2024, six major European banks were each fined more than USD 1 billion failing to comply with AML obligations. Similar penalties have been imposed in the USA. This major process of compliance, and the scale of KYC obligations, generates significant outputs (over 4.5 million SARs filed in the USA in 2024, 15 times higher than 2024???, for example), although most are of limited use. The US Treasury and Europol estimate that 95-98% of SARs are false positives, and few are used by law enforcement or national security.

Faced with the scale of compliance costs and significant penalties for non-compliance, private sector businesses understandably focus on managing the risks of non-compliance rather than the threat of financial crime. Action is also taken to reduce costs. There is a misalignment of incentives with consequential negative unintended consequences. There are also issues of effectiveness because the utility of outputs is questionable.

There have, undoubtedly, been benefits from AML regulatory interventions: banks and money service businesses have been closed in the USA and EU; patterns of fraud and sexual exploitation have been identified; and there has been some recovery of illicit funds and prosecution of criminals. There will also have been a 'chilling' effect, deterring predicate crime. Quantitative evidence of effectiveness is limited. Less than 1% of illicit funds are

recovered worldwide, although this is probably higher in the USA and EU. In the USA, only 0.5% of SARs are used by the FBI for prosecutions. Whilst benefits have been achieved there is limited evidence of scale, despite very high compliance costs and an enormous amount of activity. This needs to be placed into a wider context by looking at all costs, unintended consequences, and externalities, including opportunities and incentives for new forms of criminal activity (risk-risk outcomes).

Financial institutions must meet commercial goals. Faced with the costs and risks of AML, and the penalties for non-compliance, they focus on avoiding the risks and costs of non-compliance and managing AML compliance costs. Management of costs and risks of AML is achieved through de-banking, de-risking and reductions in service for specific low value or high-risk customer groups. These actions, in turn, trigger negative economic, social and political outcomes.

There is reduced economic dynamism because smaller businesses, cash heavy businesses, start-ups, entrepreneurs, investors and participants in emerging markets and fast growth businesses lack access to financial services. Capital flows are disrupted. Links with emerging economies are impaired; critical industries lack funds; and new technologies are prevented from spreading. The banking sector is less competitive: unproductive fixed costs impair operating efficiency, new business models are delayed and new entrants, such as FinTechs, face obstacles. The stability of the banking system is also threatened. These impacts were also highlighted by the US Federal government in the recent regulation, issued by OCC and FDIC, on the Prohibition of the Use of Reputation Risk by Regulators.

Reductions in the availability of banking services, and increased costs, for the poor, old, minorities, and people living in deprived areas increases social inequality and exclusion. More than 400,000 accounts were closed in the UK in 2024, primarily for AML-related reasons.

There have been political consequences too. Compliance with AML regulatory requirements has been used to legitimate de-banking Not-For-Profit organisations, political figures and disfavoured industries.

All of these unintended consequences are the result of behavioural change by financial institutions in response to incentives created by AML regulatory regimes.

Better Regulation takes into account the possibility that regulatory interventions create risk-risk outcomes where actions designed to target one form of harm (crime), create new forms of harm or make the existing problem worse (more or new forms of crime). This problem is endemic in mature, highly regulated societies. It was first identified at Harvard University in the 1990s, adopted by the USA in 2003; included in OECD Better Regulation guidance in 2012. It also forms part of the EU's Better Regulation toolkit.

AML regulatory regimes stimulate three additional forms of additional criminal activity, risk-risk outcomes: (1) New business opportunities for organised crime, the provision of advanced money laundering services by Chinese Money Laundering Organisations and others. (2) New forms of crime – weaponised misinformation and extortion. Criminals and other bad actors exploit AI and other technologies, along with access to Pay-to-Defame websites, to create misinformation designed to raise 'red flags' so that banks, through KYC processes, remove banking services. This is a potent form of blackmail and extortion, it combines threats to reputation with loss of access to banking, capital and financial markets. Evidence from law firms, accountants and banks confirms that it is being targeted at high-net-worth individuals, family offices, public figures and business leaders. Although academics, including Kennedy School, Alan Turing Institute and Carnegie Institute, and regulators in UK, Australia, Europol and the USA (DHS and Treasury) are becoming aware of the potential criminal threats posed by AI and Deepfakes, more is needed to raise awareness. (3) There is a growth in use of unregulated financial services, often provided by 'loan sharks' linked to organised crime, because of de-banking of the old, poor, minorities and people living in deprived areas. In the UK, more than 1 million households owe money to loan sharks each night.

AML interventions have a clear legitimate and moral purpose. However, as currently designed and implemented AML regulatory regimes lack effectiveness and create major negative externalities, including new opportunities

for criminal activities. There has been a failure to meet Better Regulation standards. The design of the AML regulatory model lacks proportionality, focuses on processes rather than outcomes, undermines innovation, creates misaligned incentives and fails to consider fully behavioural response. Unintended consequences, including risk-risk outcomes have not been adequately considered. There is a need to look again at the existing regulatory model and identify ways to improve effectiveness and limit unintended consequences.

Three steps could be taken to improve the effectiveness of the AML regulatory model. (1) Risk-risk outcomes could be identified in National AML Risk Assessments, alerting regulators and financial institutions to new forms of criminal activity triggered by AML regulations. (2) Governments can undertake extensive Ex Post Evaluations of the AML regulatory model to examine causes of ineffectiveness and unintended consequences, notably misalignment of incentives and a regulatory culture that underpins a regime that is inflexible, disproportionate, precautionary, unpredictable, focused on inputs and processes, and fails to adequately recognise second-order impacts, including risk-risk. (3) Improved regulations and guidance that align incentives, focus on outcomes, accept technological neutrality, increase predictability, focus on inherent riskiness and recognise behavioural response, including creating incentives for criminal activity.

Panel Discussion

Major Issues and Concerns

The AML regulatory regime is well-intentioned. It seeks to combat the laundering of illicit finance, prevent sanctions evasion and financing of terrorism, and deter an extensive range of major predicate crimes. Governments have a strong justification to use the powers of the State to achieve these objectives.

As originally designed, AML regulatory regimes recognised that ‘money’ connects criminal and terrorist networks and that by working with financial institutions critical intelligence could be obtained that could combat crime and terrorism. In other words, AML was primarily on information gathering and sharing regulatory intervention that was only undertaken when there was reasonable suspicion of crime or terrorist financing. This was the stated purpose of the Bank Secrecy Act of 1970.

Politicians and regulators have lost sight of the original objectives of AML. The AML regulatory regime, because of the nature of its evolution, lacks effectiveness, delivers very limited intermediate outcomes and triggers major unintended consequences. There is a major misalignment of incentives. Banks focus on managing the risk and cost of non-compliance rather than seeking to detect crime. SAR and CTR reports are filed ‘defensively’ to avoid criticism from bank supervisors, further increasing the scale of submissions to FinCEN. Supervisors do not have access to these filings, so banks submit reports rather than face penalties for failing to file. Resources are allocated to demonstrate compliance and thus avoid financial penalties and threats to reputation rather than identifying crime, reflecting the misalignment of incentives. Bank of America, for example, employed 1,200 staff in AML compliance in the USA of which less than 50 focused on detecting crime.

In its current form, the AML regime lacks simplicity, fails to focus on outcomes, creates misalignment of incentives and, within the USA, lacks leadership. Simplicity has been lost as the scale of compliance obligations has grown, leading to an over-emphasis on peripheral, unimportant issues. Overall, the regime is more concerned with processes, and compliance with them, than outcomes. All too often, money laundering has taken place in regulated entities that were in full AML compliance. Bank supervisors do not reward regulated entities that detect crime. Bank of America, for example, invested in successfully identifying healthcare fraud, yet bank supervisors did not acknowledge this and continued to focus, instead, on minor issues of programme compliance.

In too many ways, AML programmes reflect out-of-date assumptions about banking business models, transfers of value and criminal methods. The US guidance mandating the use of the Model Risk Management Framework has ossified technological development and hindered the use of AI tools to identify potential financial crime. AI

offers significant benefits for detecting financial crime, cutting compliance costs and reducing false positives. There is also very little focus on new ways in which value is transferred, such as crypto, or new forms of ‘cleaning’ illicit finance, including trade-based money laundering. The AML model struggles to keep pace with these technological changes and increasingly adaptive and sophisticated criminal methodologies.

The current AML regulatory regime lacks a clear assessment of costs and benefits. Regulated entities incur nearly \$60 billion of compliance costs in the USA, privacy rights are infringed, Constitutional protections are impaired, more than 27 million SAR and CTR reports are filed, yet less than 500 criminal investigations are triggered by AML compliance. There is a risk that with such limited evidence of tangible benefits consent amongst US citizens for continued loss of privacy of banking relationships may be lost.

As well as privacy and Constitutional impacts, the current AML model has triggered other unintended societal consequences, particularly the disproportionate impact of de-banking, and hence exclusion from participation in the modern economy, on vulnerable populations, underserved communities and charitable organisations operating in high-risk regions.

There are other human adverse impacts that have been created by the AML model, including extortion schemes using false KYC flags. These schemes involve threats of false reporting designed to trigger account closures or denial of financial services.

FinCEN, the branch of the US Treasury responsible for overseeing the AML regime, lacks human and financial resources. Investment is needed, for example, to make use of new AI tools with the capability to interrogate SARs and CTRs. There is an institutional, leadership and capacity gap.

A major challenge for regulators is to create incentives for regulated entities to make greater use of new technologies capable of cutting compliance costs, identifying crime and reducing false positives, and to focus on outcomes rather than processes and compliance with them. However, US rule-making continues to focus on specifying and supervising compliance programmes rather than delivering critical intelligence to help the US Federal Government meet its law enforcement and national security objectives.

Over time, the current AML regulatory regime has generated benefits. Using SAR and CTR data, FinCEN has issued advisory notices of financial crimes and non-compliant business that have facilitated money laundering have been shut down, for example. These benefits need to be highlighted, so that a balanced picture of costs and benefits can be developed.

Conclusions

The AML model is seriously ineffective. It has become “compliance theatre” rather than a mechanism for providing national security and law enforcement with critical intelligence.

Politicians and regulators need to recognise that it is impossible to prevent all forms of money laundering. Regulatory interventions should recognise this. It is a test of proportionality.

There has been a major failure by regulators to recognise the opportunity costs of the current AML regime. Resources have been diverted away from combatting crime and from greater innovation and enhanced operating efficiency in regulated entities.

AML regulations should recognise that financial institutions have strong incentives to carry out KYC checks, this is a fundamental banking practice, and to exclude illicit finance thus protecting trust. Future regulatory design should build on this.

Reform of the AML model should recognise that, as currently designed and implemented, it creates human ‘victims’ because of extensive de-banking and de-risking. The poor and minorities are unable to participate fully in the modern economy. Loan sharking, with its violence against the person, is encouraged. Activities by Not-for-Profit groups designed for the public good are impaired. Business enterprise, risk-taking and innovation is

undermined. New forms of crime are triggered too. Criminals create defamatory information designed to trigger KYC 'red flags' and use it to extort and blackmail high profile families, businesses and people.

Regulatory reforms in the USA, including FinCEN's proposed 'Program Rule, OCC and FDIC's rule prohibiting the use of reputational risk in bank supervision and the planned removal of the Model Risk Management Framework guidance, provide an opportunity for improvement. Ideally, these changes will encourage the adoption of more risk-based approach by regulated entities, facilitate the adoption of new technologies, and ensure less regulatory unpredictability in supervision. Reforms should, however, be assessed in terms of the extent to which they target the underlying causes of regulatory ineffectiveness, most notably the misalignment of incentives and the regulatory 'culture' that underpins the current regulatory model, and the results should be assessed using metrics of intermediate outcomes.

Recommendations

AML regimes should be redesigned to focus again on the original goal of providing useful information to governments when there are reasonable suspicions of criminal or terrorist activity. This will require considerable simplification. Financial institutions continue to offer the opportunity for national security and law enforcement to gain access to transfers of value for evil purposes, but only if AML regimes are simplified and returned to their 'roots' as exemplified by the phrase "See something, say something".

AML regimes should increasingly be based on 'principles' rather than dirigiste and inflexible obligations. Primarily, AML regimes should be designed on the basis of outcomes. This should be the most important principle.

Banks should be encouraged directly to invest in developing and training AI models to identify financial crime. This will require regulators and supervisors to revise existing regulations and guidance that inhibit the adoption of new technologies to combat money laundering.

The scale of financial, human and technological resources available for FinCEN should be increased significantly, thereby enabling greater use to be made of SARs and CTRs filed by regulated entities.

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