Anti-Money Laundering Compliance, Better Regulation and Unintended Consequences

Discussion Paper

The Huggard Consulting Group

November 2025

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EXECUTIVE SUMMARY

Reform of Anti-Money Laundering (AML) regulation is an emerging and important issue of public interest. Improving effectiveness and minimising unintended negative consequences will be key.

Intervention by governments to detect and prevent money laundering is a fundamental part of modern regulatory frameworks. It targets crime. It contributes to the preservation of law, order, and stability. It forms part of the core role and purpose of the modern state. There is a clear moral justification for using the powers of the State. It also seeks to protect the integrity of the banking system, targeting illicit money flows estimated to be in excess of 1% of global GDP. Despite the importance of the issue, we are yet to see well-designed, effective AML regulatory regimes that meet 'Better Regulation' standards, to which most governments are publicly committed.

Money laundering is not a 'victimless' crime. It enables criminal activity (known as 'predicate crime'[1]) and is necessary to disguise illegal gains. It funds serious criminal activity and is closely linked to the financing of terrorism, sanctions circumvention and to the security imperatives of the West. Acting to target money laundering is a way in which governments combat serious crimes, including fraud, drug trafficking, people smuggling and human trafficking, theft, corruption, tax crime, sexual exploitation, and environmental crime. Money laundering is a crime with serious implications across society and needs to be tackled effectively.

Today, however, there is mounting evidence that **AML regulatory interventions, as currently designed and implemented, lack the necessary effectiveness and generate significant negative externalities**. Major compliance costs, and risks, are being incurred by financial intermediaries, triggering the emergence of substantial negative unintended consequences, including de-risking, de-banking and the emergence of new forms of criminal activity (risk-risk outcomes).

In order to achieve their stated aims AML interventions use an unusual regulatory model, outsourcing major compliance and information-gathering responsibilities to the private sector. Financial intermediaries, and an increasing number of other entities, are required to monitor customers and transactions, complying with an ever-expanding list of know-your-customer, due diligence and risk management requirements set out in legislation, regulation, guidance and advice from regulators and law enforcement authorities. The costs of complying with these rules, many of which are subject to administrative discretion, combined with the scale of penalties for process and substantive failings creates incentives that distort commercial activity and create new opportunities for crime. Indeed, most of the AML-related fines imposed on financial institutions, some of which have been over USD 1 billion, have been for compliance weaknesses identified by national AML regulators rather than for failing to detect money laundering.

Faced with the scale of compliance costs (over USD 180 billion globally) and significant penalties for non-compliance, **financial institutions increasingly seek to manage the risks of non-compliance rather than the threat of financial crime.** This is a rational business response, reflecting commercial, compliance, risk management and legal factors. When combined with the design of AML requirements, these business priorities trigger the submission of enormous numbers of Suspicious Activity Reports (more than 4 million per annum in the USA) to law enforcement, of which 95-98% are believed to be false positives. There is a major misalignment of incentives between regulated entities and law enforcement. Moreover, the management of the risk of process failure by private sector entities generates very large numbers of Suspicious Activity Reports (SARs), the scale of which risks **overwhelming the capacity of law enforcement to reduce criminal activity**, potentially defeating the primary purpose of AML regimes.

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[1] Predicate crime (or a predicate offence) is a criminal act that generates illicit funds which are often used in a larger criminal enterprise, most commonly money laundering or financing terrorism.

The ultimate objective of AML regulatory interventions is to increase the likelihood that criminals get caught, confiscating the proceeds of crime and prosecuting perpetrators. **Whilst there have been benefits,** less than 1% of illicit laundered funds are estimated to be recovered and law enforcement reportedly makes use of very few AML reports to trigger prosecution. However, AML regulations clearly also act as a deterrent, although this is very difficult to quantify. **Using a traditional benefit-cost analysis, one of a number of possible metrics of effectiveness, benefits appear to be significantly less than the compliance costs borne by regulated entities.**

Unsurprisingly, financial institutions take a series of steps to control the costs of AML compliance and to limit the risk of process failure, whilst meeting commercial goals. Many engage in extensive de-risking of business activities, including de-banking existing customers and restricting new business development. In turn, this leads to **negative economic outcomes**. **(1)** There is reduced economic dynamism, due to the de-banking of small companies, sectors and entrepreneurs; **(2)** flows of capital and ideas are impaired because linkages with emerging economies, or utilisation of new technologies, are disrupted; **(3)** the competitiveness of the financial service sector is distorted; and **(4)** there are also potential threats to the banking system as the base of depositors is reduced. Moreover, the threat of enforcement from national law enforcement agencies against financial institutions can be exploited by bad actors, effectively giving some parties a convenient and quasi-governmental leverage point over legitimate actors who may be susceptible to reputational or other attacks.

There are **major social consequences** as well. De-risking and de-banking, and the need to cut other operating expenses, to accommodate high compliance costs, contribute to the reduced availability and increased cost of basic banking services for the poor, old and minorities, thereby increasing social exclusion.

Risk-risk outcomes are a characteristic of many regulatory decisions. They occur when measures targeted at reducing one source of harm, such as money laundering, trigger the emergence of new or similar forms of harm, such as new opportunities for criminal activity. Risk-risk outcomes limit the benefits of the original regulatory intervention. This has occurred with AML regulatory regimes. New opportunities for crime have emerged. **(1)** Organised crime has begun to offer sophisticated, specialist money laundering services, a new line of 'business'. **(2)** There is also the emergence of sophisticated forms of extortion, exploiting AI, Deepfakes, fake news and websites, as well as pay-to-defame mechanisms, to target legal entities and individuals, preventing them from gaining access to financial services by exploiting AML compliance requirements. **(3)** At a social level, de-banking of the poor and minorities, as financial institutions seek to manage the costs and risks of AML compliance, can shift financial activity from regulated to unregulated, often criminal, providers of financial services (loan sharks et al).

Overall and notwithstanding their legitimate, moral purpose, it seems likely that **AML regulatory interventions, as currently designed and implemented, lack effectiveness and create major negative externalities**. They fail to meet Better Regulation standards. Design of AML regulatory interventions has overlooked, for instance, misalignment of incentives and behavioural response of regulated entities. Unintended costs, including risk-risk outcomes, have been overlooked. Insufficient use of cost effectiveness analysis has limited the understanding of regulators as to the impacts of the progressive increases in the scope of AML requirements.

Action is needed to reform AML regulatory interventions. Possible improvements include: (1) **Ex Post Evaluations**, to examine the causes of ineffectiveness; **(2) Risk-Risk Outcomes** to be highlighted in National Risk Assessments so as to identify new forms of criminal activity created by AML requirements; (3) **New Regulatory Design Principles**, including greater use of public resources, proportionality, incentives to focus on high risk, less subjectivity, technological neutrality, outcomes focus, avoid market distortion, protect innovation and **(4) Cost Effectiveness Analysis,** to assess increases in regulatory scope.

The Huggard Consulting Group, October 2025

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1. Background

Intervention by governments to detect and prevent money-laundering is a fundamental part of modern regulatory frameworks. It targets crime. It contributes to the preservation of law, order and stability. It forms part of the core role and purpose of the modern state. There is a moral justification for the use of the powers of the State for this purpose.

Well-designed and enforced Anti-Money Laundering regulatory regimes (AML), reduce incentives to commit a wide range of crimes, facilitate the recovery of the proceeds of criminal activity, help prevent sanctions evasion and other national security threats, and disrupt the financing of terrorism. They also help protect the integrity of the wider financial system.

Money laundering is not a 'victimless' crime. It enables criminal activity (known as 'predicate crimes'[2]) and is necessary to disguise illegal gains. It funds, moreover, serious criminal activity and is closely linked to the financing of terrorism, sanctions evasion and other transnational threats. Increasingly, however, government interventions designed to combat money laundering are also creating opportunities for new forms of criminal activity.

Acting to target money laundering is one of the ways in which governments seek to combat serious forms of crime, including fraud, drug trafficking, people smuggling and human trafficking, theft, corruption and bribery, tax crime, sexual exploitation and environmental crime.[3]

Well-designed AML regulatory interventions, moreover, seek to meet modern standards of regulatory quality to ensure effectiveness, to limit negative unintended consequences and to ensure that actions to prevent crime do not, through behavioural responses, create new opportunities for criminal activity. This approach to designing and enforcing interventions, based on clear standards and processes, is often described as 'Better Regulation', and has been adopted throughout the OECD area. It requires, amongst other standards, interventions to be necessary, proportionate, effective and targeted; based on credible evidence; and, informed by a robust understanding of all costs and benefits, including unintended consequences. Interventions should be outcomes-based, technologically neutral, facilitate innovation and avoid distorting the functioning of markets, whenever possible.

There is, however, increasing concern that, in many cases, AML regulatory interventions, whilst undoubtedly justified in both moral and systemic terms, fail to meet these demanding standards, leading to ineffectiveness, significant negative unintended consequences and new opportunities for criminal activity.

In the United States, for example, concerns have been raised about the economic and social consequences of de-banking because of the costs and reputational risks faced by banks as they seek to comply with AML regulatory requirements. Such problems have also been recognised by the Financial Action Task Force.[4] There are concerns in Europe, as well. A recent report by the Irish Banking and Payments Federation highlighted the

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[2] Predicate crime (or a predicate offence) is a criminal act that generates illicit funds which are often used in a larger criminal enterprise, most commonly money laundering or financing terrorism.

[3] See for example threats identified in US Office of the Treasury 'National Money Laundering Risk Assessment 2022' (2023), US Office of the Treasury 'National Money Laundering Risk Assessment 2024' (2025), Government of the United Kingdom 'National Risk Assessment of Money Laundering' (2025) and Government of Luxembourg 'National Risk Assessment of Money Laundering and Terrorist Financing' (2025)

[4] Financial Action Task Force 'Mitigating the Unintended Consequences of the FATF standards' (2021). FATF is an intergovernmental body set up in 1989 to co-ordinate the development of national AML policies.

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negative impacts of regulatory compliance costs on the competitiveness of the financial services sector in Ireland.[5] The scale of compliance costs and the need for the European Union's AML regulatory regime to be reviewed using Better Regulation principles was also raised by the Centre for European Policy Studies.[6] Public controversies too have been inflamed by AML regulatory requirements. Regulators and banks have de-banked politically disfavoured groups, persons and industries.

This Discussion Paper responds to these and other concerns. It is a contribution to an emerging debate about how to improve the AML regulatory framework. Using the concepts and standards of Better Regulation it examines AML regulatory interventions, assessing effectiveness, and identifying unintended negative consequences, including some of the ways in which AML requirements have created new opportunities for criminal activity (known as 'risk-risk' outcomes).

2.   Anti-Money Laundering Regulation and State Intervention – Problem Definition

Better Regulation standards require governments to demonstrate that society or the economy faces major challenges that the use of the powers of the State can, or should, resolve, prior to implementing legal or regulatory interventions.

AML interventions meet this standard. They seek to solve critical problems of criminal activity, terrorist financing and material challenges to the wider financial system. Modern states exist, in part, because they ensure law and order, protect life, liberty and property, prevent crime, protect against violent subversion and maintain stability. Actions to achieve these goals, including AML regulatory regimes, are a legitimate use of the powers of the State, helping to ensure that the social contract with citizens is fulfilled. In this context, AML regulatory interventions have a form of moral purpose.

AML regulation, compliance and enforcement has become a central feature of the regulatory framework of most countries. Along with disrupting terrorist financing, AML regulatory regimes seek primarily to create disincentives to major criminal activities, fraud, drug trafficking, people smuggling and human trafficking, theft, corruption and bribery, tax crime, sexual exploitation and environmental crime. These are known as 'predicate' crimes, in that they generate illicit funds that must be absorbed into legal forms through some form of money laundering. AML requirements, and their enforcement, seek to contribute to law enforcement by making it more difficult to convert illicit into legal funds, by detecting and prosecuting criminal activity and by aiding the recovery of illicit funds and assets.

One of the most pertinent justifications of the need for major AML regulatory interventions is the overall scale of money laundering activity. The UN Office on Drugs and Crime believes that the estimated amount of money laundered could be between 2% and 5% of global GDP.[7] EU estimates are lower. Europol, for example, estimates that the scale of money laundered in the EU could be as high as 1.4% of EU GDP.[8] Investigations into specific banks, found to have been used for laundering illicit funds, provides further evidence of the scale of the problem. For example, a bank in Estonia was closed by regulators after it was revealed that it had been used to facilitate more than USD 1 billion in money laundering.[9] Whilst estimates of the scale of money laundering vary, it is clearly a very significant problem.

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[5] Banking and Payments Federation Ireland 'BPFI, Regulating Growth – A Roadmap for Simplification' (2025)

[6] Centre for European Policy Studies 'Anti-Money Laundering in the EU, Ensuring effective cross-border co-operation and mutual trust: time to get serious' (2021)

[7] UN Office on Drugs and Crime 'Money Laundering' – current estimate shown on UN website (2025)

[8] See European Commission 'Impact Assessment accompanying the Anti-money laundering package' (Staff Working Document, 2021)

[9] Kirschenbaum J. Veron N., and Porcaro G 'A Better European Architecture to fight Money Laundering' (Bruegel Policy Contribution, 2018)

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Governments are also aware that money laundering, because of its scale and nature, poses threats to the integrity and stability of the international financial system. Work by the International Monetary Fund identified the potential impact of laundered funds on asset prices, stability of individual banks, reputation of international financial centres and threats to access to correspondent banking.[10]

In the light of these challenges, governments throughout the world have taken steps to set up major AML regulatory regimes, beginning with the Bank Secrecy Act of 1970 in the USA.

Whilst there is a clear rationale for government intervention, based on the relationship between the modern State and citizens, the purpose of the State, and the scale and nature of the threats posed by money laundering to societies, it is important that the form taken by such actions should reflect Better Regulation standards, so as to ensure that negative unintended consequences ('externalities') are minimised and benefits maximised, thereby delivering important public policy goals in the most effective manner possible.

3. AML Regulatory Interventions and Better Regulation

Better Regulation is a governance philosophy. It is an approach to designing and implementing interventions that seeks to ensure effectiveness and to limit unintended consequences. In turn, it seeks to build consent for the use of the powers of the State. It is based on a clear, evidence-based intervention logic. It forces regulators to address difficult questions. It requires robust identification of benefits, even if they are hard to measure. It highlights the need to identify, and, if possible, quantify complex costs, including the impact of behavioural change. It highlights the importance, in mature regulatory contexts, of assessing the possibility of creating new or additional harms, due to regulatory interventions. It also requires regulators to be willing to consider revising and improving regulatory regimes, if the initial design and subsequent enforcement is insufficiently effective.

It is based on a set of standards and implemented by regulators and legislators using a range of processes, including consultation, impact assessment, benefit-cost analysis, cost effectiveness analysis and ex post evaluation. At its most complete, a Better Regulation strategy informs the entire policy-making cycle, encompassing design of laws and regulations, and their implementation through enforcement, guidance, and regulatory decision-making processes. It provides, moreover, a transparent framework for decision-making that, at its best, facilitates accountability.

The origins of the Better Regulation approach lie in a series of recommendations adopted by OECD members in 1995, 2005 and 2012,[11] and governance reforms implemented by major jurisdictions such as the US Executive Order for Regulatory Planning and Review from President Clinton in 1995,[12] supported by the technical guidance issued by the Federal Office of Management of Budget in 2003,[13] and the adoption by the European Union of a Better Regulation Strategy and Guidance beginning in 2003, with the latest communication in 2021.[14]

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[10] International Monetary Fund 'Macroeconomic Impact of Illicit Financial Flows' (Background Paper, 2023)

[11] See OECD 'Recommendation of the Council of the OECD of Improving the Quality of Government Regulation' (1995), OECD 'OECD Guiding Principles for Regulatory Quality and Performance' (2005), and OECD 'Recommendation of the Council on Regulatory Policy and Governance' (2012)

[12] US Government 'Presidential Executive Order, Regulatory Planning and Review' (Clinton Whitehouse, 1993 Executive Order 12866)

[13] US Office of Management and Budget 'Circular A-4, Regulatory Analysis' (2003) – this guidance was reinstated by the Trump Whitehouse

[14] See European Commission 'Better Regulation: Joining Forces to make better laws' (Communication from the Commission to the European Parliament, the Council, The Economic and Social Committee and the Committee of the Regions, 2021) and European Commission 'Better Regulation Guidance' (Staff Working Document, 2021)

Better Regulation seeks to ensure that interventions are necessary, effective, predictable, legitimate, and proportionate. It achieves this through adherence to a series of core standards for interventions. (1) They should be developed using transparent and participatory decision-making processes. (2) They should be based on credible evidence, providing a sound intervention logic. (3) They should target the problem and its causes, defining measurable outcomes. (4) They should be informed by a transparent understanding of costs and benefits, particularly unintended consequences and risk-risk outcomes. (5) They should be reviewable over time.[15]

Interventions, and their implementation, are also more likely to be effective, if they are outcomes-based rather than focused on processes or inputs, technologically-neutral, least burdensome and more proportionate, responsive to change, and designed to enhance, rather than limit, incentives, innovation and competitiveness.[16]

As well as meeting these general standards, **designing and implementing effective AML regulatory interventions requires a number of specific challenges to be addressed, if important policy goals are to be achieved and negative externalities minimised**. These include:

- **Scope of mandatory requirements and regulated entities** – this requires regulators to consider problems of feasibility of regulatory interventions, and hence benefits that can be achieved, when determining the scale of reporting, the number and types of crimes to be targeted and the types and numbers of entities to be regulated. For example, if the scope is set too wide then high-risk activities may be overlooked, because the capacity and capability of regulators and law enforcement to identify serious harms may be swamped by the scale of reports from regulated entities.
- **Benefits** – if regulators are to demonstrate that the powers of the State have been employed effectively then, ultimately, they must provide a robust assessment of benefits. Better Regulation standards require benefits to be quantified, wherever possible, and include a baseline that can be used to demonstrate change. If it is difficult to provide quantified estimates of the extent to which the ultimate regulatory goals have been achieved, then meaningful intermediate measures should be adopted. (In contrast, the creation and adoption of processes and structures, or fines for process failings, are 'inputs' and thus form the initial stage of performance measurement only. They are not benefits or outcomes.)
- **Response of regulated entities** – the AML regulatory model relies extensively on compelling private sector actors to scrutinise customers and transactions. This creates problems for the potential effectiveness of AML regulatory interventions because there is a misalignment of incentives between the regulator and the private sector actors. Whilst acknowledging that the private sector does not wish to facilitate crime, something that is damaging for commercial activity and the trust on which it is founded, businesses have a duty to maximize returns. On the other hand, regulators are seeking, when enforcing AML regulations, to combat crime. This misalignment leads to a significant behavioural response and hence unintended consequences. Good regulatory design recognises this and seeks to find ways to limit these consequences.

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[15] For many regulatory interventions, Better Regulation standards require clear evidence that benefits justify costs, a form of utilitarian assessment. This is, however, not an appropriate standard for considering interventions that are undertaken to meet the core role of the modern state. In contrast, the challenge is to ensure that such interventions are as effective as possible, whilst limiting negative unintended consequences, particularly new opportunities for criminal activity. Better Regulation provides a governance philosophy, supported by a set of standards, mechanisms and tools, for achieving this.

[16] See Allio L. and Meads R. 'Novel Regulatory Philosophies in the European Union: Directions, Implications and the Role of Better Regulation' (European Regulation and Innovation Forum, Monograph, 2023)

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>   **Risk-risk outcomes** – an important but often overlooked 'cost' of many regulations introduced in mature societies is the creation of new or increased harm as a result of the new mandatory requirements. This is known as risk-risk.[17] It is a widespread phenomenon. It is important, therefore, when seeking to minimise negative unintended outcomes, to identify the potential for AML requirements to create new opportunities for criminal activity or to amplify the scale of existing illegal activities. Better Regulation standards explicitly recognise this.

These issues can be assessed by examining the AML regulatory model that has been adopted by many jurisdictions and then identifying its benefits and costs.

4. AML Regulatory Model

AML regulatory regimes use an unusual regulatory model. They directly engage private sector entities in the law enforcement process through the imposition of extensive, mandatory requirements to monitor customers and transactions, and to identify and report 'suspicious transactions' to regulators. This complex approach poses major design and enforcement challenges if Better Regulation standards are to be met, benefits maximised and negative unintended consequences, including risk-risk outcomes, limited.

Whilst the origins of AML regulatory interventions lie in the United States in the 1970s, the wider global approach began at the end of the 1980s with the establishment by a group of national governments of the Financial Action Task Force (FATF). This inter-governmental institution draws up standards for the policy, legal and institutional architecture that national governments should adopt to combat money laundering, and then provides a peer review process to ensure adherence to these process standards. Failure to adopt FATF standards leads to jurisdictions being placed on lists, stigmatising them and potentially limiting their involvement in the global financial system. Standards have been steadily updated and expanded. Adherence to FATF standards is not an outcomes-based measure of the effectiveness of AML regulatory interventions, rather it is a necessary pre-condition or 'input' measure.

Since the early 1990s, jurisdictions throughout the world have adopted AML regulatory regimes, with a major expansion of activity after the terrorist problems of 2001. One of the features of AML regulation, particularly in the EU and the USA, has been a steady expansion in the number of private sector entities subject to it ('regulated entities'), the scale of mandated know-your-customer (KYC) requirements, the number of predicate crimes to be identified and the development of new forms of somewhat subjective customer risk designation, such as 'high risk' and 'politically exposed persons'. Many of these increased requirements are, moreover, set out in detailed guidance that focuses on inputs and compliance rather than outcomes. This expansion has increased significantly the scale of compliance costs, as well as the number of 'Suspicious Activity Reports' (SARs) and 'Cash Transfer Reports' (CTRs) submitted by regulated entities to regulators.

In the EU, for example, the First Money Laundering Directive was adopted in 1991. Subsequent directives steadily extended the scope of the intervention, with major expansions in regulated entities, customer due diligence requirements, enhanced due diligence, predicate crimes and customer risk categories being added in the Fourth Directive (2015) and Fifth Directive (2018).[18] The latest Directive (Sixth) will establish greater centralised direction, including an EU Anti-Money Laundering Agency.[19]

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[17] See Graham J. and Wiener J. (Risk vs Risk: Trade-offs in Protecting Public Health and the Environment' (1997), Wiener J.B. 'Managing the Iatrogenic Risks of Risk Management' (Risk, Vol.39, 1998)

[18] See Centre for European Policy Studies 'Anti-Money Laundering in the EU, Ensuring effective cross-border co-operation and mutual trust: time to get serious' (2021)

[19] European Commission 'Anti-money laundering and countering the financing of terrorism legislative package' (2021)

Central to national AML regulatory regimes is the involvement of profit-seeking private sector entities in the law enforcement process. Effectiveness, measured in terms of predicate crimes deterred, prosecutions or illicit assets confiscated, is primarily dependent on the ability of the private sector to detect suspicious activity. This is then reported to the regulator, usually through the national Financial Investigation Unit, where reports of suspicious activity are assessed before being passed on to law enforcement.

Compliance with process standards by regulated entities is enforced by AML and other regulators, including bank supervisors, and process or substantive failings are punished by major financial penalties and threats to reputation. Fines are punitive. In the period 2014-2024, six major European banks were each fined over USD 1 billion for AML process shortcomings.[20]

This unusual regulatory model has a number of distinctive characteristics. These include:

- **Costs of compliance are borne primarily by regulated entities in the private sector, and, moreover, these costs have risen significantly over time.** This has become a major business problem for regulated entities and the management of them has triggered unintended consequences.
- **There is a misalignment of incentives between profit-seeking entities and law enforcement.** Regulated entities have strong incentives to reduce compliance costs that do not create business value, and to avoid penalties for process failings. They do, however, have commercial incentives to avoid reputational damage, because of the importance of intangible assets as 'drivers' of business value. This does not necessarily, however, lead to a greater alignment of incentives between regulated entities and AML regulators.
- In response to the threats to financial returns and reputation posed by AML regulatory regimes, **regulated entities increasingly focus on managing the risk of non-compliance with AML processes rather than combatting financial crime.** This limits the effectiveness of AML regulatory interventions.
- Extensive, detailed mandatory know-your-customer, due diligence, extended due diligence and risk categorisation requirements set out in legislation and guidance by **regulators focus primarily on processes and activities ('inputs') rather than outcomes.** This encourages regulated entities to focus on process-based compliance rather than risk-based assessments. This limits further the effectiveness of AML interventions and stimulates the creation of very large numbers of Suspicious Activity Reports (SARs) and Cash Transfer Reports (CTRs), many of which are of little value to law enforcement. It also triggers unintended consequences.
- Fines for AML process or substantive failings are, for some major financial institutions, linked to wider bank supervision, focused on prudential and stability factors. This provides the **opportunity for greater administrative discretion and hence more involvement of regulators in the strategies of regulated entities. It also facilitates politicisation**.
- Expansion of the scope of AML regulatory requirements has included the **adoption by governments of ill-defined, subjective concepts**, such as 'high risk', 'reputational risk' or 'politically exposed', that can be used by regulated entities or regulators to limit access to financial services. These concepts, unless well-designed and limited in application, provide a basis for discretionary decision-making and politicisation.
- **The complexity and scope of AML regulatory regimes may create opportunities for new forms of criminal activity, further limiting the effectiveness of interventions**. These are known as Risk-Risk outcomes.

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[20] Whyte J. 'De-banked: The Economic and Social Consequences of Anti-Money Laundering Regulation' (Institute for Economic Affairs, Discussion Paper No.125, 2024)

- It is also important to question the extent to which regulators understand fully the scale of compliance costs imposed on regulated entities by AML requirements. In the USA, for example, the AML regulator, FinCEN, estimated that completion of a single Suspicious Activity Report (SAR) required less than 2 manhours. In contrast the banking industry, based on expert input from regulated entities, estimated that the same task required an average of over 21 hours.[21] Moreover, the use of Cost Effectiveness Analysis, to assess the impact of the steady increases in scope of AML regulatory requirements, appears to be incomplete.[22] Without a full understanding of compliance costs, regulators cannot assess the potential behavioural response of regulated entities and thus wider unintended consequences.

One of the most evident characteristics of AML regulatory regimes is the scale of compliance costs imposed on regulated entities. In 2020, it was estimated that global compliance costs **exceeded USD 180 billion**, with the EU, UK and USA accounting for more than 80%.[23] Banks estimate, moreover, that more than 10% of staff are employed on compliance with AML requirements, a major source of fixed costs and a driver of negative changes in bank competitiveness.[24] A survey of nineteen major banks in the USA provided insights into the link between compliance and the usefulness of reports to regulators. More than 2.4 million customers of this group of banks met mandatory 'high risk' criteria and as such were subject to extensive and high-cost monitoring. However, only 6% of these 'high risk' customers generated an SAR.[25]

A further indicator of the scale of compliance, and how it has grown over time, is provided by the **number of SARs filed** in specific jurisdictions. In the USA, for example, regulated entities filed over 4.5 million SARs in 2024, growing from 0.3 million in 2003.[26]

Despite these significant costs, it is important to also consider the extent to which reports provided to regulators prove **useful to law enforcement**. There are problems, however. Evidence from the EU suggests that 95-98% of SARs submitted by regulated entities were 'false positives'.[27] US evidence supports this. In 2017, it was identified by regulators that 96% of SARs and 99% of CTRs required no follow up by law enforcement.[28] More recent US evidence revealed that only 0.5% of SARs were used by the FBI in an investigation.[29]

Whilst it is clear that the scale of mandatory compliance costs incurred by regulated entities is significant, it would be misleading to suggest that without regulation there would be no investment in anti-money laundering processes by the private sector. It is likely that banks and other financial institutions would invest in some anti-money laundering technologies and processes to retain trust and to protect reputation, by ensuring that assets and transactions are not tainted by associations with crime. Banking is based on trust.

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[21] Submission by Bank Policy Institute to FinCEN, US AML regulator, as part of review undertaken in compliance with the Paperwork Reduction Act in 2024.

[22] Allio L. and Meads R. 'Cost Effectiveness Analysis and Risk Management Decision-Making' (European Risk Forum, Highlights Note 11, 2020)

[23] LexisNexis 'True Cost of Compliance Report' (2020)

[24] European Banking Federation 'Lifting the Spell of Dirty Money – EBF blueprint for an effective EU framework to fight money laundering' (2020)

[25] Bank Policy Institute 'Getting to Effectiveness – Report on US Financial Institution Resources devoted to BSA/AML and Sanctions Compliance' (2018)

[26] Klein A. 'Investigating the Real Impacts of De-banking in America' (Testimony from the Brookings Institution to the US Congress, House Banking, Housing and Urban Affairs Committee, 2025)

[27] European Commission 'Impact Assessment accompanying the Anti-money laundering package' (Staff Working Document, 2021)

[28] Bank Policy Institute 'Getting to Effectiveness – Report on US Financial Institution Resources devoted to BSA/AML and Sanctions Compliance' (2018)

[29] Bank Policy Institute 'The Truth About Account Closures' (2024)

Reputation is one of the most important intangible assets of a financial institution and, as such, a critical driver of business value. These investments create benefits that enhance competitiveness.[30]

Moreover, it is also evident that the scale, nature and utility (for law enforcement) of the mandatory expenses imposed on regulated entities poses major problems for their competitiveness. Therefore, it begs the question as to the extent to which the incremental benefits for regulated entities from compliance with AML regulation exceed those that would have been obtained without compulsion.[31]

The AML regulatory model delivers some benefits. However, it clearly generates significant compliance costs that may pose risks to regulatory effectiveness and may trigger unintended consequences due to behavioural responses by regulated entities. Better Regulation standards require interventions to demonstrate a robust understanding of benefits and costs, including unintended consequences.

5.   AML Regulatory Regimes and Compliance - Benefits

The ultimate objective of AML regulatory interventions is to reduce the scale of predicate crimes, including financing terrorism, by increasing the likelihood that criminals will be caught, confiscating the proceeds of crime and prosecuting perpetrators. Better Regulation standards require these outcomes to be identified and, where appropriate and possible, quantified, so that informed assessments of the effectiveness of AML requirements can be undertaken.

Current AML regulatory regimes target a wide range of serious predicate crimes that generate illicit funds that need to be converted into legal forms. These include fraud, drug trafficking, people smuggling and human trafficking, theft, corruption and bribery, tax crime, sexual exploitation and environmental crime Money laundering also funds serious criminal activity and is closely linked to the financing of terrorism. Combatting it is an issue of major importance to governments.

Over time, there is evidence that AML regulatory interventions have produced benefits. These include closure and financial punishment of banks that have facilitated money laundering in Europe; use by US law enforcement of SARs to track ransomware and wildlife trafficking; and criminal convictions and recovery of illicit assets in the EU, UK and USA. It is also possible that the implementation and enforcement of AML regulatory requirements has had a deterrent effect on predicate crimes and the laundering of the proceeds of crime. This 'chilling' of criminal activity is, however, difficult to identify or to measure.[32]

It is, however, difficult to ascertain the overall extent of benefits from compliance with AML requirements. There is a lack of accurate knowledge of the scale of the problem of predicate crime and associated money laundering, making it difficult to establish a baseline and hence determine whether there has been deterrence of criminal activity, the ultimate objective of AML regulatory regimes. This also makes it difficult to measure any wider 'chilling effect' of AML regulatory interventions, and their enforcement, on the motivations and activities of criminals and terrorists. In view of the difficulty of measuring the ultimate outcomes of the intervention, regulators have to focus on intermediate outcomes to demonstrate potential benefits, most notably use of AML reports by law enforcement, numbers of prosecutions and the scale of recovery of illicit funds. Here there are also problems because of the difficulties of demonstrating the specific causal impact of AML reports rather than other sources of information about criminal activity.

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[30] See for example, McKinsey 'Why anti-money laundering should be a top priority for financial institutions' (2019) and Thomson Reuters 'How banks can turn the KYC compliance challenge into a competitive advantage' (2025)

[31] See for example, Sathye M. Nicoll G. and Chadderton P. 'Regulatory Focus on Competition and Innovation in Payment Services' (Swift Institute Working paper, 2015)

[32] See for example, Government of New Zealand 'Impact Assessment for AML Phase II Legislation' (2017)

Whilst it is difficult to measure reductions in predicate crimes or the extent to which law enforcement use AML compliance reports, it is important to recognise that financial punishments of regulated entities for AML process or substantive failings do not constitute an alternative means of quantifying the impact of the intervention. These are measures to improve 'inputs' to the regulatory process. They are not directly related causally to the ultimate objective of the intervention and hence do not meet Better Regulation standards for the determination of benefits.

Some research has, however, been undertaken to try and **estimate the scale of benefits of AML regulatory regimes.** A global study suggests that AML regulatory requirements contributed to the confiscation of 0.05% of illicit laundered funds in the period studied.[33] Estimates for the EU suggest a higher success rate of confiscation of about 1-2% of illicit laundered funds.[34] Whilst the studies acknowledge the imperfections of available data, they highlight the likelihood that, relative to the scale of the problem, **AML regulatory regimes appear to have generated some benefits.**

Data for the use of AML reports by law enforcement reinforces this. Very few SARs and even fewer CTRs, are of use to law enforcement due to the very high rate of 'false positives'. This leads to relatively little exploitation of AML reports. In the USA, for example, only about 370 prosecutions by the IRS were triggered by information from SARs and CTRs in 2023.[35] In the EU, it is estimated that data from only 1% of SARs leads to prosecutions.[36] These are very low levels of usage of AML reports by law enforcement.

A further problem facing law enforcement is that the design of AML regulatory requirements, and the steady expansion of its scope by national regulators, may lead to **high-risk problems being overlooked because of the scale of SAR and CTR reporting.** In some cases, the number of reports may 'swamp' the capacity and capability or regulators and law enforcement to separate criminal activity from 'false positives'. This limits the effectiveness of AML regulatory regimes.

Overall, there is some but limited evidence of significant benefits from AML regulatory interventions, measured through reductions in predicate crime, increased prosecutions, the scale of seizures of illicit funds or deterrence.

This analysis is, however, incomplete. It is important to identify the additional unintended economic, social and political consequences that are the result of the design and enforcement of AML requirements. This requires recognition of behavioural change by regulated entities, stimulated by AML compliance, and incentives created for additional criminal activity because of AML design and enforcement (risk-risk outcomes).

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[33] Pol R. 'Anti-money laundering: the world's least effective policy experiment? Together we can fix it' (Policy Design and Practice, 2020)

[34] See Centre for European Policy Studies 'Anti-Money Laundering in the EU, Ensuring effective cross-border co-operation and mutual trust: time to get serious' (2021) and Europol 'The Other Side of the Coin – An Analysis of Financial and Economic Crime' (European Financial and Economic Crime Threat Assessment, 2023)

[35] Klein A. 'Investigating the Real Impacts of De-banking in America' (Testimony from the Brookings Institution to the US Congress, House Banking, Housing and Urban Affairs Committee, 2025)

[36] European Banking Federation 'Lifting the Spell of Dirty Money – EBF blueprint for an effective EU framework to fight money laundering' (2020)

6. AML Regulatory Regimes and Compliance - Unintended Economic, Social and Political Consequences

6.1. De-Banking

AML compliance costs create major commercial problems for regulated entities. Direct costs are significant and rising, and the financial and reputational costs of process failings are high. AML design and enforcement also creates scope for subjective decisions, creating opportunities for politicisation and the inappropriate influence of activists, regulators and politicians in operational decision-making. The behavioural response of regulated entities to these challenges creates negative unintended economic, social and political consequences.

These problems are resolved in several ways. Direct costs are reduced through the **closure of smaller accounts** that are complex, require additional due diligence, or lack the profitability necessary to recover basic AML compliance costs. Regulated entities assess the contribution margin of accounts against the costs of AML compliance and make commercial decisions. This is known as de-banking.

At the same time, regulated entities assess the costs and reputational risks of exposure to certain groups of customers, sectors, countries, technologies and transactions that could be deemed to be unacceptably 'high risk'. In turn, this leads to **banking services being withdrawn**, if regulated entities deem the costs or risks to be unacceptable. This is an additional form of de-banking and is described as de-risking.

Whilst regulators are aware of de-banking and have highlighted some of its negative consequences, there is, as yet, **limited understanding of its underlying causes**, specifically the design and enforcement of AML compliance regimes, as well as the progressive expansion of regulatory requirements. There appears to be a failure by regulators to recognise adequately the misalignment of incentives between profit-seeking regulated entities and law enforcement.

Rather than seeking to prevent crime, the focus of regulated entities is on reducing the enforcement risks to the financial institution, limiting the direct costs of AML regulatory compliance, and managing reputational risks. This process of cost and risk reduction generates three types of significant unintended consequences:

- Economic (section 6.2.)
- Social (6.3.)
- Political (6.4.)

6.2. Economic Unintended Consequences of AML Compliance Requirements

De-banking of customers and de-risking to avoid exposure to certain sectors, technologies, markets and transactions creates several **unintended economic consequences**. These include:

- **Impairment of economic dynamism** – this is due, in part, to de-banking smaller businesses (particularly those handling large sums of cash in sectors such as retail, hospitality, in-person services) and the reduction in availability of banking services for smaller businesses engaged in trading with or investing in emerging economies. Trade flows are also impaired. There are difficulties in accessing trade finance, undertaking international transactions with new business partners, working with new suppliers and penetrating new markets. These obstacles affect entrepreneurs, fast growth smaller businesses and

start-ups.[37] There are also wider impacts because access to banking services is lost by a wide range of smaller business customers whose profitability is unable to cover AML compliance costs.

- **Obstacles to the flow of capital and ideas** – AML due diligence requirements make it difficult for capital and ideas to flow into and out of emerging economies, because regulated entities make de-risking decisions, in order to avoid compliance costs and reputational threats. It is also more difficult to manage invested assets across borders, creating obstacles to portfolio diversification. Over time, these restrictions further limit economic dynamism and distort the global allocation of capital.
- **Distortion of competitiveness in financial services businesses** – AML compliance significantly increases fixed costs in the financial services sector, without creating business value. It also reduces income from smaller customers, trade finance and cross-border transactions. Higher fixed costs and lower margins from traditional markets erode operating efficiency, one of the drivers of competitiveness. Reduced efficiency, risk averse culture and higher operating leverage due to AML compliance costs also shapes pricing and service decisions, limiting innovation and customer satisfaction. Innovation is also impaired because AML compliance incentivises financial service businesses to de-risk and avoid investment in legal technologies and sectors deemed by regulators or activists to be 'high risk', such as crypto or blockchain.[38] New business models, such as those adopted by so-called FinTech businesses, also face obstacles due to AML compliance costs and requirements, limiting competitive intensity and slowing down structural adjustment.
- **Weakening of the financial system** – there is increasing concern amongst some regulators that the scale of de-banking, in response to the costs and risks of AML compliance, may lead to a material reduction in the depositor base.[39] A further threat to the financial system is the diversion of financial activity and flows, that law enforcement would wish to monitor, into alternative and untraceable assets (crypto etc.) as a result of de-banking and de-risking.

Economic unintended consequences of regulatory interventions should be considered fully prior to implementation, if Better Regulation standards are to be met. For AML regulatory interventions, this requires a comprehensive understanding of the behavioural response of regulated entities as a result of the misalignment of incentives, the scale of direct compliance costs and the costs and risks of enforcement.

6.3.   Unintended Social Consequences of AML Compliance Requirements

Access to a bank account is a pre-requisite for full participation in the economy for individuals as well as companies. Households rely on banks for the safe keeping of savings and for providing access to credit. **De-banking of small value accounts**, due to the direct costs and risks of AML compliance, reduces access to banking services particularly for the poor, older citizens, the disabled, minorities and people living in deprived areas.[40]

This has become a **significant problem**. In the UK, for example, banks removed services from more than 340,000 accounts in a single year, of which more than 50% of closures were due to AML regulatory requirements.[41] In some cases the cost of AML compliance exceeded margins, particularly for smaller accounts, whilst in other cases the risk profile of activities created compliance costs that were not consistent with account profitability goals.

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[37] See for example, Klein A. 'Investigating the Real Impacts of De-banking in America' (Testimony from the Brookings Institution to the US Congress, House Banking, Housing and Urban Affairs Committee, 2025)

[38] See for example, Bank Policy Institute 'The Truth About Account Closures' (2024)

[39] See US Congressional Research Service 'Anti-Money Laundering – An Overview for Congress' (2017)

[40] See Financial Action Task Force 'Mitigating the Unintended Consequences of the FATF standards' (2021)

[41] Whyte J. 'De-banked: The Economic and Social Consequences of Anti-Money Laundering Regulation' (Institute for Economic Affairs, Discussion Paper No.125, 2024)

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In order to recover the high cost of AML compliance, financial institutions also take **additional steps to preserve margins and profitability**. Fees for banking services and minimum balance requirements are increased. Access to physical banking services is reduced with the closure of branches. These increases in costs and reductions in services tend to affect poorer, older, and minority customers disproportionately. Many are unable to afford to maintain higher minimum balances, to pay additional fees or travel to the few remaining bank branches. In turn, they lose access to a bank account.

A further problem for minorities and migrants is that banks often place restrictions on remittances and cash transmission businesses because of AML compliance and reputational risks posed by the sources and destinations of funds.

Loss of access to banking services has significant wider impacts. It contributes to social and economic inequality. Approximately 10% of the US population was either unbanked or was unbanked at some point in 2024, according to recent research.[42] It is particularly prevalent amongst those on low incomes, minorities and the disabled, making it difficult for these groups to participate in the economy and to access future opportunities.[43]

Good regulatory practice, set out in Better Regulation standards, requires regulators to consider the potential social impacts of interventions. To do this, behavioural responses of regulated entities must be considered fully.

6.4. Political Unintended Consequences of AML Compliance

The progressive expansion of the scope of AML regulatory requirements requires regulated entities increasingly to consider ill-defined and subjective concepts, such as 'high risk', reputational risk' and 'politically-exposed', when making decisions about whether to provide banking services to specific customers. This has created problems for compliance, incentives for de-risking, opportunities for greater administrative discretion by regulators and facilitated politicisation of banking decisions.

De-risking has affected Not-for-Profit organisations adversely. In some instances, financial institutions have been unwilling to provide banking services because of perceived reputational risks due to concerns about sources and applications of funds, as well as potential links to the funding of terrorism. The Financial Action Task Force has identified this problem and encouraged national governments to take steps to limit its impact. Loss of banking services effectively defunds Not-for-Profit organisations, undermining political discourse.[44]

There has also been **politicisation of banking decisions**, using AML compliance requirements and enforcement to target politically disfavoured sectors and groups. In the USA, for example, these issues have generated significant controversy and concern.[45]

Other examples of politicisation of banking decisions, using the subjective concepts now embedded in AML compliance requirements, include the influence of activists on banks to de-bank political opponents or to try and shape the strategies of their customers because of perceived 'reputational risk'. In the UK, for example, a leading bank recently tried to de-bank the leader of a major political party, triggering controversy.

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[42] US Federal Deposit Insurance Corporation 'National Survey of Unbanked and Underbanked Households' (2024)

[43] Klein A. 'Investigating the Real Impacts of De-banking in America' (Testimony from the Brookings Institution to the US Congress, House Banking, Housing and Urban Affairs Committee, 2025)

[44] Financial Action Task Force 'Mitigating the Unintended Consequences of the FATF standards' (2021)

[45] See Zywicki T.J. 'Political De-Banking' (International Center for Law & Economics, George Mason Law and Economics Research Paper, No.25, 2025) and Bank Policy Institute 'The Truth About Account Closures' (2024)

It was not the intention of regulators that AML compliance should be used to limit political discourse. However, poor regulatory design, that fails to meet the standards of Better Regulation, has facilitated this.

7. AML Regulatory Regimes and Compliance - "Risk-Risk" Outcomes

Regulators have begun to recognise that the design and enforcement of AML has generated significant negative externalities, mostly linked to de-banking and de-risking. There is, however, emerging evidence that **AML policy interventions designed to target crime have created new opportunities for crime, a group of unintended, negative impacts. A series of risk-risk outcomes appear to have emerged. These additional harms undermine the effectiveness of AML regulatory regimes.**

Risk-risk outcomes occur when **interventions designed to manage the threats posed by one particular harm, such as the predicate crimes that lead to money laundering, trigger behavioural and other responses that create new additional harms or exacerbate the damage from the targeted problem.**

Such outcomes are endemic in mature, highly regulated contexts. Their causes and nature were identified initially at Harvard University in the 1990s,[46] and the importance of identifying and ameliorating this form of unintended consequence became part of the OECD's regulatory principles in 2012.[47] Better Regulation standards require risk-risk outcomes to be considered when interventions are designed ('ex ante') and when effectiveness is evaluated after implementation ('ex post').

AML regulatory interventions target crime, as a source of harm. There is emerging evidence, however, that it has, through its design and enforcement, created opportunities for at least three forms of additional criminal activity. Specifically:

(1) New business opportunities for organised crime – money laundering services;

(2) Extortion through "weaponised misinformation", using AI and Deepfakes amongst other technologies; and

(3) Expansion of the use of unregulated financial services, including loan sharking, operated by organised crime.

Regulators are increasingly aware of the growth in **new criminal business opportunities for specialist money laundering services offered by organised crime**. In part this is the result of the expanding scope of AML regulatory regimes, along with the continuing profitability of predicate crimes that AML regulatory interventions target. One example is the growth of sophisticated, specialised businesses based in China offering advanced money laundering to drug traffickers in the USA (Exhibit 1):

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[46] See for example, Graham J.D. and Wiener J.B. eds. 'Risk vs Risk: Trade-offs in Protecting Public Health and the Environment' (1997); Wiener J.B. 'Managing the Iatrogenic Risks of Risk Management' (Risk, Vol.39, 1998); Sunstein C.R. 'Health-Health Trade-Offs' (Coase-Sandor Institute for Law & Economics Working Paper, No.42, 1996); Lofstedt R. and Schlag A. 'Risk-risk trade-offs – what should we do in Europe?' (Journal of Risk Research, 2016)

[47] OECD 'Recommendation of the Council on Regulatory Policy and Governance' (2012)

Exhibit 1

Risk-Risk – New Business Opportunities for Organised Crime

Chinese Money Laundering Organisations

Money laundering organisations are not new, but recently US law enforcement has identified the growing prevalence of innovative, highly professional Chinese Money Laundering Organisations (CMLOs), exploiting modern technology and digital banking.

These are highly skilled, sophisticated organisations that use a "black market foreign exchange system" to match individuals with a supply of US dollars with others wanting US dollars. They exploit the desire of drug trafficking organisations to repatriate the proceeds of crime into Mexico or Colombia, and wealthy Chinese nationals restricted by China's capital flight laws from transferring large sums of money held in Chinese bank accounts for use abroad. Using modern technology, they can offer competitive fees, rapid pay-out options, and guarantees against losses, often disguising themselves behind legitimate business activity.

CMLOs operate by offsetting transfers of money such that they avoid moving money across borders. For example, a Mexican drug trafficking organisation in the US might supply bulk US dollars to a CMLO in the US. The CMLO's operation in Mexico rapidly pays the Mexican drug operation in pesos in Mexico. The CMLO often then uses a processor in the US to advertise and sell US dollars to wealthy Chinese nationals in the US, who use it to buy assets and support their lifestyles (often involving gambling), which capital flight restrictions would otherwise limit. The wealthy Chinese individual then makes a China-to-China bank transfer into an account controlled by the CMLO. To complete the circle, the CMLO then uses Chinese money to buy pesos in Mexico using Chinese expat business people in Mexico who want to repatriate profit to China, or Mexican importers.

CMLOs are often associated with larger transnational criminal organisations and have now become one of the key actors in professional money laundering in the US and worldwide. The innovative model that they have developed manages to avoid cross border money movement and escape AML restrictions.

Source: The Huggard Consulting Group (2025), US Treasury 'National Money Laundering Risk Assessment' (2022) and (2024)

Similarly, professional money laundering organisations have now established parallel underground financial systems in Europe to process transactions and payments away from the surveillance systems governing the legal financial system. For example, Europol estimates suggest that circa 30% of criminal networks in the European Union make use of professional money laundering organisations and underground banking systems.[48]

Whilst regulators have been alerted to the growth of some of the business opportunities for organised crime created by AML compliance and enforcement, they have yet to fully realise the potential for criminal activity that emerges from the interaction of the design and enforcement of AML requirements with Artificial Intelligence, Deepfakes, fake news websites and other digital tools.

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[48] Europol 'The Other Side of the Coin – An Analysis of Financial and Economic Crime' (European Financial and Economic Crime Threat Assessment, 2023)

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'Weaponised misinformation', combined with AML regulatory requirements, creates new opportunities for crime, particularly extortion and blackmail (Exhibit 2).

Exhibit 2

Risk-Risk

"Weaponised Misinformation" and Extortion

Artificial intelligence (AI) is enabling the creation of "deepfakes" which allow criminals to generate misinformation that can be exploited for extortion.[49] Together with "fake media" websites that publish fake news, there is growing concern[50] about the opportunities for criminals to extort money from individuals and companies.

Recent work by the Carnegie Endowment for International Peace[51] has examined the potential threats to the financial system from "deepfakes", using a roundtable of over thirty international experts from the financial sector, technology industry and the regulatory community. They concluded that synthetic media will inflict harm on targeted individuals and businesses. The Alan Turing National Institute for Science and Artificial Intelligence in the UK has also concluded that the proliferation of AI systems is re-shaping the landscape for on-line criminal activity, including the ability to conduct extortion on a significant scale both of companies and individuals.[52]

Criminals exploit the interaction between the ability of AI to create misinformation, the availability of so-called "pay to defame" websites that can share the misinformation, and AML requirements that flag concerns to financial institutions.

"Pay to defame" websites are fraudulent sites, often designed to look like genuine media outlets, that target business leaders, entrepreneurs, companies, politicians and pools of private capital. The website itself lacks transparency about who created it, who administers it, and who writes the fake news hosted on it. These sites are often populated with real reports, rewritten using AI to give the sites legitimacy. Fake news and other forms of misinformation are hidden within and amongst the legitimate stories. Articles are not designed to attract readership but to be highly visible to search engines, capitalising on sophisticated search engine optimisation tools, so that articles appear at or near the top of Google searches for a victim's name and are found by research companies providing information to financial institutions for AML purposes.

The aim of criminals is to threaten to raise "red flags" amongst banking and investment counterparties that are undertaking due diligence or extended due diligence as part of a Know-Your-Customer (KYC) risk assessment to meet AML requirements. Such "red flags" could be based on misleading, false information or unfounded allegations of corruption, fraud or embezzlement that attack the reputation or damage the track record of a businessperson or company. Recent work by the Harvard Kennedy School supports this. It concluded that deep fakes are used to create fraudulent documents sophisticated enough to by-pass traditional checks of veracity, facilitating criminal exploitation of KYC and AML risk assessments.[53] Taken together these forms of weaponization of misinformation can lead to the inability to invest and the loss of access to the global banking system. Criminals exploit the ultra-precautionary approach taken by financial institutions as a result of AML requirements. Criminals can extort serious sums of money, which is then laundered.

Source: The Huggard Consulting Group (2025)

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[49] See for example, US Department of Homeland Security 'Impact of Artificial Intelligence on Criminal and Illicit Activities' (2024)

[50] See for example, Aris B. 'The Fake Media Shakedown' (BNE Intellinews, 2023); Cartwright G. 'Countering Disinformation: Politicians and Individuals are Targeted by Fake News' (EU Today, 2023); Smale B. 'Firms Going to War Against Rivals on Social Media' (BBC, 2022)

[51] Bateman J. 'Deepfakes and Synthetic Media in the Financial System: Assessing Threat Scenarios' Carnegie Endowment for International Peace (2020)

[52] Burton J., Janjeva A., and Moseley S. 'AI and Serious Online Crime' (Alan Turing Institute, UK National Institute for Data Science, Research Report 2025)

[53] Wagman S. 'Weaponised AI: Era of Threats and How We Can Counter It' (Harvard Kennedy School, Ash Centre for Democratic Governance and Innovation, 2025)

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In Italy, the recent 'Equalize' scandal illustrates another dimension of the potential for criminal activity, particularly extortion, created through the interaction between modern digital information tools and AML regulatory requirements. In this instance, hundreds of thousands of records from government databases, the dark web and other sources (including flagged financial transactions and criminal investigations) were collated to create detailed compromising profiles on senior politicians, well-known business leaders and other prominent figures, for the purposes of extortion and blackmail.[54]

Finally, **AML compliance increases the demand for traditional forms of unregulated financial activities, including loan sharking.** This is another form of risk-risk outcome. It occurs because of the scale of AML compliance costs and a misalignment of incentives between regulated entities and regulators that, in turn, triggers de-banking of smaller accounts. These problems disproportionately affect the poor, disabled people, older citizens, minorities and residents of deprived areas.

These groups still require some form of access to banking services, particularly the provision of short-term credit. Many people on low or irregular incomes lack a 'cushion' of savings needed to compensate for disruptions in earnings. Without access to regulated banking, 'loan sharks' and other unregulated providers meet this essential need. Many of these providers are linked, directly or indirectly, to organised crime.

AML design and implementation has, without intent, exacerbated one of the traditional activities of organised crime (Exhibit 3).

Exhibit 3

Risk-Risk

AML Compliance Costs and Unregulated Financial Services

De-banking of individuals as a result of bank AML compliance processes has fueled the growth in demand for credit provided by unlicenced money lenders, outside of the AML system. This growth in demand for illegal credit has facilitated the expansion of unregulated money lending operations, helping criminals to launder money obtained from other illicit activities.

Illegal lenders have stepped in to fulfil a basic need for credit, spurring the growth of un-regulated financial services such as unlicenced money lenders or "loan sharks". Whilst not a new phenomenon, de-banking has exacerbated the demand for such services. Typically, these people offer rapid, short-term small loans, but charge extremely high interest rates (often 300-400%) and add arbitrary additional charges, which push the overall total repayments to very high levels over much longer periods. Little paperwork is involved, bank cards, passports or valuables are often taken as security, and threatening behaviour can also take place. Social media is often used to attract 'customers' and subsequently to intimidate them. Whilst some loan sharks are small scale local lenders, others are disguised businesses (e.g. a shop used as a front for money lending), whilst others are linked to large scale organised crime groups. Many of them are looking to launder money obtained from illegal activity such as drug trafficking.

A recent study by a UK think tank estimated that over 1 million people in England are now in debt to illegal money lenders. [55] These are predominantly low-income individuals, with low financial resilience, relying on benefits, living in social housing, often with long term health conditions and with other existing debts to legitimate authorised creditors (such as council tax arrears). Many of them are cut off from mainstream legal banking options, with over a third having previously attempted to borrow from banks, but 80% of these being refused a loan.

Source: The Huggard Consulting Group (2025)

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[54] Roussi A. and Roberts H. 'How a hacking gang held Italy's political elites to ransom' (Politico 27 October 2025)

[55] See Centre for Social Justice 'Swimming with Sharks' (2022) and Government of Luxembourg 'National Risk Assessment of Money Laundering and Terrorist Financing' (2025)

Despite the importance of these negative unintended outcomes, awareness and recognition by regulators of the risk-risk outcomes created by AML design and enforcement remains limited. The inclusion of these threats in National Money Laundering Risk Assessments, a reporting requirement demanded of jurisdictions by the Financial Action Task Force, would represent major progress. Whilst some attention is being paid to the emergence of new money laundering criminal businesses, there is insufficient recognition of the potential for "weaponised misinformation", combined with AML regulatory requirements, to facilitate large-scale blackmail and extortion, and to the greater use of criminal unregulated financial services due to de-banking

Better Regulation standards require regulators to identify and take into account all such risk-risk outcomes when seeking to understand fully the negative unintended consequences of regulatory interventions.

8.   Conclusions and Recommendations

8.1.   Conclusions

Intervention by governments to combat money laundering is a legitimate and important use of the powers of the State. Anti-money laundering regulations seek to preserve law and order, to prevent violent subversion, to ensure stability and to prevent crime. Achieving these objectives is a critical function of the modern state. This is a powerful intervention logic, that is further strengthened by the scale and nature of the predicate crimes involved, and the need to protect the integrity of the wider financial system.

Money laundering is a serious criminal problem. Laundering of illicit gains enables serious crimes to be carried out, including fraud, drug trafficking, people smuggling and human trafficking, theft, corruption and bribery, tax crime, sexual exploitation and environmental crime. In turn, money laundering funds serious criminal activity, and is closely linked to the financing of terrorism.

This is, however, a **difficult problem for governments to solve**. There is a lack of knowledge of the true scale of illicit finance that is laundered, making it difficult to establish a benchmark against which to assess the scale of benefits from the intervention. A further problem is the necessity of engaging the private sector in the process of law enforcement, creating an unusual regulatory model.

This regulatory model is, however, encountering serious difficulties. Private sector compliance costs are significant in scale. There are also major economic, social and political unintended consequences that are the direct result of the AML regulatory model. Finally, AML requirements, and their implementation, have created new opportunities for criminal activity: there are important risk-risk trade-offs including new money laundering business opportunities for organised crime; 'weaponised misinformation' used for extortion; and increased demand for unregulated financial services provided by criminals.

When all these issues are considered, it is evident that AML regulatory regimes, based on the current design and enforcement model, lack effectiveness and generate major negative externalities.

There are number of reasons why this has occurred many of them the result of the failure of regulators, when designing and implementing AML regulatory interventions, to follow the standards of Better Regulation set out by the OECD and others. Design of AML regulatory regimes appears to have inadequately considered the problems of the misalignment of incentives between law enforcement and regulated entities, and the likely behavioural responses of profit seeking businesses to the high costs, risks and penalties of enforcement. Regulated entities focus on managing the risks posed by compliance failings rather than tackling crime. A further problem is that most AML regulatory interventions focus on processes and detailed 'dirigiste' requirements, set out in legislation, regulation and guidance, rather than outcomes. Subjective categorisations have been added as well, creating scope for politicisation.

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It may also be the case that insufficient attention has been paid to adhering to the core principles of proportionality, most notably the selection, wherever possible, of the least burdensome form of intervention.[56]

Moreover, **the scope of AML regulatory requirements has grown steadily** since the early 2000s, and this poses additional Better Regulation challenges that appear to have been inadequately addressed. There is, for example, relatively little evidence that regulators have employed Cost Effectiveness Analysis (CEA) to identify and compare the marginal benefits of increasing scope, measured in terms of ultimate and intermediate outcomes, against increases in compliance costs. CEA is a well-established analytical tool used by regulators to assess the impact of regulations that build on existing frameworks and to identify when improved or revised regulatory design can lead to greater benefits.[57]

There has also been a failure by regulators to consider, sufficiently rigorously, the possibility that **AML requirements create increased opportunities for new criminal activity**. These are **risk-risk outcomes**, whereby interventions designed to combat crime have created new forms of crime. FATF standards require countries to identify 'emerging threats': these threats, all of which are predicate crimes for money laundering, appear to have been overlooked. They should be more prominent in National Risk Assessments.

A further problem is the extent to which governments have used private, rather than public, resources to try and deliver one of the core functions of the modern state, namely the enforcement of criminal law. Today, there is evidence that outsourcing the combatting of money laundering is insufficiently effective. Arguably, the balance has shifted too far in favour of private actions, leading to insufficient investment by governments in public resources. There are multiple mechanisms for combatting money laundering, including making greater use of the expertise of specialist law enforcement organisations.

Action is needed to overcome these failings and, if appropriate, adopt new and improved regulatory models that will improve effectiveness, limit negative unintended consequences and avoid creating opportunities for new forms of criminal activity.

8.2.   Recommendations

The way forward, however, is not for governments to step back from seeking to combat money laundering and the financing of terrorism. These are problems that the powers of the State should be used against. For the future, the emphasis must be on redesigning AML regulatory regimes, and their implementation.

Many ideas have been advanced to achieve this. This is an issue of emerging public interest. FATF recommendations urge governments to take action to re-focus AML regulatory interventions on the basis of risk.[58] In the EU, there are calls for more emphasis on risk rather than process, ex post evaluation, better impact assessment and the application of Better Regulation principles, particularly proportionality.[59]

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[56] Allio L. and Meads R. 'Proportionality Principle and the Management of Risk' (European Risk Forum, Highlights Note 12, 2020)

[57] See for example, Allio L. and Meads R. 'Cost Effectiveness Analysis and Risk Management Decision-Making' (European Risk Forum, Highlights Note 11, 2020); Viscusi K.W. 'Mortality Effects of Regulatory Costs and Policy Evaluation Criteria' (The RAND Journal of Economics, Vol 25, 1994); Morrall J. 'Saving Lives- A Review of the Record' (AEI Brookings Joint Centre for Regulatory Studies, 2003); and Graham J.D. 'Saving Lives Through Administrative Law and Economics ' (University of Pennsylvania Law Review, Vol 157, 2009)

[58] Financial Action Task Force 'High-level Synopsis of the Stocktake of the Unintended Consequences of FATF standards' (2021)

[59] See for example European Banking Federation 'Lifting the Spell of Dirty Money – EBF blueprint for an effective EU framework to fight money laundering' (2020) and Centre for European Policy Studies 'Anti-Money Laundering in the EU, Ensuring effective cross-border co-operation and mutual trust: time to get serious' (2021)

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In the USA, there are proposals to eliminate 'political' de-banking, to reduce the discretion of the Administrative State, including requiring regulations, guidance and quasi-guidance to meet the standards set by OIRA, and to limit the ability of regulators to use AML regulatory requirements to micro-manage the operational and strategic decisions of financial institutions.[60]

More generally, however, it is possible, based on Better Regulation standards, to identify four major recommendations for all AML regulatory regimes:

(1) **Ex Post Evaluation** – all AML regulatory regimes should be subject to extensive ex post evaluation, designed to assess all benefits and costs, identify reasons for regulatory ineffectiveness and develop improvements to design and enforcement[61].

(2) **Risk-Risk** – national governments should review National Risk Assessments and ensure that they fully recognise the emerging threats that are the result of AML requirements creating opportunities for criminal activity. This should include new money laundering businesses, the potential for "weaponised misinformation' (using AI, Deepfakes et al) as form of extortion, and greater use of unregulated financial services.

(3) **Design Principles** - new regulatory design principles are needed that, for instance, incentivise regulated entities to focus on areas of high risk, to reduce focus on low risk and to seek ways to better align incentives. The scope for politicisation must also be eliminated to strengthen the legitimacy of AML regulatory interventions. Specifically, new AML regulatory regimes should be based on the following principles:

- Make greater use of public sector resources – shift the balance away from undue reliance on private sector compliance
- Create incentives for regulated entities to focus on high risk rather than compliance – seek to align incentives
- Adhere to the principles of proportionality;
- Focus on the outcomes of regulation rather than 'dirigiste' inputs and activities;
- Limit the scope for subjectivity of interpretation of concepts that have facilitated politicisation;
- Ensure technological neutrality, enable regulated entities to make decisions about appropriate technological and other tools to achieve outcomes;
- Avoid distortion of the functioning of markets, including trade and capital flows, entry and exit of firms and the adoption of new business models;
- Ensure that innovation is not impaired.

(4) **Cost Effectiveness Analysis** – all AML regulatory regimes should commit to applying cost effectiveness analysis to all future interventions that expand the scope and requirements for regulated entities. CEA should also be used as part of ex post analysis of existing AML regulatory requirements.

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[60] See Judge K. 'Financial Regulation beyond Stability' (Journal of Law, Economics and Policy, Vol.19, 2024), Ray P. 'A distinction without a difference: on the case for OIRA review of rules by independent financial regulators' (Journal of Law, Economics and Policy, Vol.19, 2024, and Bank Policy Institute 'The Truth About Account Closures' (2024)

[61] See for example, Allio L. and Meads R. 'Ex Post Evaluation – Assessing Regulatory Outcomes' (European Risk Forum, Policy Brief 03, 2008); Hahn R.W. and Tetlock P.C. 'Has Economic Analysis Improved Regulatory Decisions' (Journal of Economic Perspectives, vol. 22, 2008); US President Executive Order, 'Improving Regulation and Regulatory Review' (Obama Whitehouse, 2011, Executive Order 13563); Parker D. and Kirkpatrick C. 'Measuring Regulatory Performance – The Economic Performance of Regulatory Policy' (Expert Paper No.3, OECD, 2012); Lutter R. 'Regulatory Policy: what role for retrospective analysis and review' (Journal of Benefit-Cost Analysis, Vol.4, 2013); OECD 'Reviewing the Stock of Regulation; OECD Best Practices for Regulatory Policy' (2020); and Coglianese C. 'Evaluating Regulatory Performance' (University of Pennsylvania Journal of Law and Public Affairs, 2024)

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