Event Note

ILCC Financial Services Event
Banque de Luxembourg, 10 February 2026

'Viewed from a Better Regulation Perspective, are current approaches to AML/CFT Fit for Purpose?'

On 10 February 2026, the ILCC (The Ireland Luxembourg Chamber of Commerce) hosted a High-Level Financial Services Event in the auditorium of the Banque de Luxembourg. With more than 100 registrants from the banking, financial services sector and regulatory communities, the event was designed to address the Effectiveness of AML/CFT and KYC Regulation. The participants heard contributions from a panel of speakers with extensive industry experience: **Richard Meads,** Director of Business Decisions Limited, **Brian Hayes**, Chief Executive Officer, Banking and Payments Federation Ireland and former Irish Government Minister, **Jerry Gribic,** CEO of the Luxembourg Bankers' Association, and **Yann Power**, Governance and Compliance specialist. The discussion was moderated by **Joseph Huggard**, Chairman of the ILCC:

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 the 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 1995 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 1.4% of the EU's 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 opportunities for 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, followed this approach, including 2024 reforms to establish a common, harmonised rule-book, a centralised AML agency and the Sixth Directive to clarify national institutional requirements.

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'.

The AML regulatory model has generated 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. 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. Europol and the US Treasury 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. Only 1-2% of illicit funds are recovered in the EU and less than 1% of SARs are used 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 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. 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 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 Deepfake 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. (3) Improved

regulations and guidance can be implemented that are more proportionate, align incentives (including the importance of trust for banks) and focus on outcomes rather than processes.
Panel Discussion – the eminent panel made a number of points.

AML regulatory interventions have a moral purpose, including creating stability and trust in the banking system. These are essential conditions for a stable society. Banks have obligations to protect the savings of depositors and establish trust. These are powerful intangible assets that drive the creation of value. Banking is, as an economic activity, dependent on trust. Future AML interventions need to harness these private sector incentives to create a better alignment between the desire of governments to combat crime and the competitive pressures on banks to establish trust.

International financial centres compete to attract capital. To achieve this, they must increasingly demonstrate to investors that they are 'clean', in other words that rigorous, systemic steps have been taken to eliminate the influence of flows of illicit funds. Compliance, by all major market participants, with the highest AML standards helps to demonstrate this, and helps build the reputation of the financial centre.

Historically, the EU has focused on reducing systemic risk in banking, as a result of the 2008 financial crisis. This has improved the stability of the EU banking system. Relatively limited attention has been paid, however, to the unintended consequences of the AML regulatory model. There is, for example, little awareness at EU-level of the impact of de-banking, due to the response of financial institutions to the costs of compliance and the risks and costs of non-compliance, on social exclusion, functioning of the economy or the competitiveness of the banking sector. The creation of the new EU Anti-Money Laundering Agency (AMLA), and the need for extensive guidance and comitology, to implement new regulatory requirements, provides an opportunity for the EU to make its AML regulatory model more effective and to reduce its compliance costs, and consequent unintended consequences.

De-banking is best understood as encompassing not just the removal of existing banking services but also the denial of services to new customers, including international clients. It is influenced by the costs of carrying out AML obligations and the reputational or compliance risk of entering into the relationship. Some of the sectors that face de-banking challenges include small businesses trading across borders, private equity businesses and investors, and businesses or investors with complex ownership and investment structures.

AML regulatory interventions have a significant impact on banking competitiveness. There is, for example, a major problem of opportunity cost because critical resources of up to 15% of staff and 40% of capex are diverted into activities that do not add value, making innovation more difficult, limiting improvements in service provision and reducing operating efficiency. Dirigiste, process-based obligations also limit the application of modern technologies, such as AI, to improve the detection of potential criminal activities, and hence make AML compliance more effective.

Risk-risk outcomes remain little understood. There is a need to raise awareness of the ways in which AML regulatory interventions create new opportunities for criminal activity. It cannot have been the intention of regulators to create new business lines for Chinese money launderers, to expose prominent high net worth individuals to potent forms of extortion, or to give a new lease of life to loan sharks. Regulators and financial institutions need to focus on these new forms of crime.

The event concluded that actions to combat money laundering, as currently designed and implemented, are not optimal when it comes to effectiveness. Concern was raised that the system creates significant negative externalities. It was noted that there is a need for a formal examination of the causes of these deficiencies. Raising awareness of new opportunities for criminal activity being created was seen as beneficial, as were efforts to achieve a better alignments of incentives between governments and the private sector such that costs of compliance could be more effectively used.