

# Anti-Money Laundering: Opportunities for Improvement

Kathryn Judge and Anil K Kashyap

## Abstract

The current anti-money laundering regime is complicated, expensive and seems far from effective. This paper examines the path-dependent processes through which this regime evolved and expanded over time. It then uses multiple different approaches to assess just how well the system is performing, and at what cost. Although efficacy is hard to measure, the analysis suggests meaningful room for improvement. Against this backdrop, the paper proposes eight principles for enhancing the efficacy and efficiency of the current regime and enabling it to better respond to evolving policy priorities. An important theme is that there is a trilemma between effective AML, protecting civil liberties, and promoting financial inclusion, although there is significant room for improvement before reaching those fundamental tradeoffs. A good first step toward reform would be a blue-sky, holistic review of the current system.



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The **Wharton Initiative on Financial Policy and Regulation** is directed by **Itay Goldstein**, the Joel S. Ehrenkranz Family Professor and Professor of Finance at The Wharton School of the University of Pennsylvania. It commissions white papers from leading and emerging experts on a range of topics on financial policy and regulation. For more, see <https://wifpr.wharton.upenn.edu/>

# Wharton Initiative on Financial Policy and Regulation White Paper

## Anti-Money Laundering: Opportunities for Improvement<sup>1</sup>

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### Abstract

The current anti-money laundering regime is complicated, expensive and seems far from effective. This paper examines the path-dependent processes through which this regime evolved and expanded over time. It then uses multiple different approaches to assess just how well the system is performing, and at what cost. Although efficacy is hard to measure, the analysis suggests meaningful room for improvement. Against this backdrop, the paper proposes eight principles for enhancing the efficacy and efficiency of the current regime and enabling it to better respond to evolving policy priorities. An important theme is that there is a trilemma between effective AML, protecting civil liberties, and promoting financial inclusion, although there is significant room for improvement before reaching those fundamental tradeoffs. A good first step toward reform would be a blue-sky, holistic review of the current system.

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## INTRODUCTION

The United States' current anti-money laundering (AML) regime is expansive, expensive and one of America's most important domestic public-private initiatives. It impacts everyone who uses financial services and can affect access to those services. It plays a pivotal role in facilitating law enforcement, strengthening efforts to combat corruption around the world and facilitating the use of sanctions. It can also impinge on civil liberties, oftentimes in ways that are not apparent. Despite the myriad public values at play and benefits from making the system work well, the public and academic debate on the topic is extremely limited.

This paper begins to lay the groundwork needed to enable a broader, more informed debate about the design and contours of the AML regime in the United States. It provides a framework for understanding the inherent tradeoffs in this enterprise. It also offers some core principles that could enhance the system's efficacy without meaningfully increasing the costs, economic and otherwise, associated with its operations.

Part I provides a brief survey of the history and evolution of anti-money laundering efforts in the United States. This history reveals a largely one-way ratchet, as both the aims and scope of the AML regime expand over time, albeit with some efforts at rebalancing.

Part II starts by reviewing what can be measured regarding the functioning of the AML regime and then moves to the question of how well the system is working. Relative to an alternative of no AML rules, the system is an obvious improvement. Against more realistic benchmarks, it is much harder to say how well the system's aims are being met, but several indicators suggest it is falling far short of what is possible.

Part III offers a framework for assessing where there may be opportunities for meaningful improvements. Its starting point is a call for a more holistic approach to AML, both across time and across domains. It translates this concept into actionable principles that can be used to identify the types of reforms likely to yield the greatest fruit. A critical supporting suggestion is to perform a blue-sky assessment of the system to collect other perspectives on its performance. This part also offers a framework and thoughts for identifying the tradeoffs often at play. There are no easy answers for how to resolve some of these tradeoffs, but clarifying what is at stake can help reveal inconsistencies in how competing values are handled and lay the groundwork for such issues to be resolved by Congress, the courts, and other appropriate mechanisms.

### I. PATH DEPENDENT EVOLUTION

Today's AML regime is too complex and multi-dimensional for a paper of this length to do it justice, even if the sole focus was on describing how the regime works. The aim here is thus a far more modest effort to provide a rudimentary sketch of how the AML regime in the United States evolved and to characterize the current aim, design and scope of that regime. Without this background, many aspects of the system appear to be mysterious and perhaps even misguided.

The foundation of today's anti-money laundering regime dates to 1970, when Congress passed the Bank Secrecy Act (BSA).<sup>4</sup> Building on programs that Treasury already had in place, Congress sought to ensure that law enforcement would have access to the records they needed to enforce "the myriad criminal, tax and regulatory provisions of laws which Congress had enacted."<sup>5</sup> In the hearings leading up to the passage of the BSA, Congress heard about how the dearth of such a law facilitated insider trading, other forms of white-collar crime and organized crime and how powerful individuals and corporations were using secret foreign bank accounts to circumvent compliance with U.S. laws.

The BSA codified and significantly expanded the obligations imposed on "financial institutions" to keep records of customer accounts and transactions, enabling law enforcement to more easily obtain such records, and to affirmatively report any cash transactions in excess of \$10,000. Congress also imposed an affirmative reporting obligation on individuals, requiring them to report foreign financial accounts with values in excess of \$10,000.<sup>6</sup>

The structure of the original BSA contains two important design features that continue to shape AML today. First, Congress has given the Treasury Department broad discretion to implement, and thereby also update, the regulations needed to put these new mandates into practice. Second, the regime has both recordkeeping and affirmative reporting obligations, with the latter having grown more expansive over time.

The array of obligations the BSA imposed sparked immediate controversy, leading to multiple constitutional challenges. The banking industry raised due process concerns challenging whether banks could be used as tools of private statecraft. The American Civil Liberties Union filed suit raising privacy concerns and associational interests under the First Amendment. There were also questions about whether bank customers had a Fourth Amendment interest in information a bank retained and subsequently turned over to law enforcement.<sup>7</sup> There were even

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<sup>4</sup> Bank Secrecy Act, 31 U.S.C §§ 5311-5336.

<sup>5</sup> California Bankers Ass'n. v. Shultz, 416 U.S. 21, 27 (1974).

<sup>6</sup> The \$10,000 trigger used in multiple places in the scheme has never been modified. Because of inflation, this means that more than 50 years later, the number of covered transactions and accounts is much greater than at the time the BSA became law.

<sup>7</sup> United States v. Miller, 425 U.S. 435 (1976).

concerns that Congress had delegated too much of its lawmaking prerogative in vesting the Treasury Department with so much discretion.

In a series of split decisions, involving shifting majority coalitions, the Supreme Court upheld the breadth of the authority vested in the Treasury Department and it decided the regime adequately shielded individuals from unreasonable seizures of private information.<sup>8</sup> These foundational decisions have continued to undergird the constitutionality of today's AML regime, even as it has expanded and even as technology has transformed just how much can be gleaned from one's financial transactions. We turn briefly to some of the major expansions.

### **A. War on Drugs**

The first set of significant AML expansions came during the 1980s and early 1990s and was often intertwined with the "War on Drugs." The Money Laundering Control Act, enacted in 1986, established money laundering as a federal crime and gave law enforcement new authority to compel civil and criminal forfeiture for BSA violations.<sup>9</sup> The legislative history suggests Congress intended this as a way of criminalizing activity that facilitated the drug trade, and not allowing those who facilitated in the flow of such funds to cleanse themselves from responsibility.<sup>10</sup> That Act also illustrates the ways that amendments to the BSA are often byproduct of lawmakers learning about weaknesses in the regime as it had been operating.

After realizing that people could and had structured transactions so as to avoid automatic reporting triggers, Congress forbade such gamesmanship. In a similar spirit, Congress imposed new and more robust obligations on banks to develop internal controls to promote compliance with their BSA obligations.<sup>11</sup>

Institutional change accompanied these statutory developments. In 1990, the Treasury Department created the Financial Crimes Enforcement Network (FinCEN), a division within the Treasury department designed to facilitate implementation of the BSA and support local, state, federal and international law enforcement by analyzing the information required under the BSA. In the Annunzio-Wylie Anti-Money Laundering Act two years later, Congress expanded FinCEN's role and created a new Bank Secrecy Act Advisory Group (BSAAG).

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<sup>8</sup> California Bankers Ass'n, 416 U.S. at 27; Miller, 425 U.S. 435.

<sup>9</sup> Money Laundering Control Act, 18 U.S.C. §§ 1956-1957.

<sup>10</sup> 18 U.S.C. § 1956(a); S. Rep. No. 99-433, at 2-8 (1986).

<sup>11</sup> Two years later when Congress made a drug-free America an explicit policy aim and adopted a host of new penalties and positions to further that aim in the Anti-Drug Abuse Act of 1988, it also included provisions expanding the scope of AML obligations, reflecting the close entanglements between the War on Drugs and the burgeoning AML regime. Anti-Drug Abuse Act of 1988, Pub. L. No. 100-690, 102 Stat. 4181.

BSAAG membership is granted to institutions, not individuals, including financial institutions, trade groups, federal and non-federal regulators and U.S.-based law enforcement agencies. This reflects the diverse range of participants whose insights are needed to create an effective system for combatting money laundering and the need for outside experts. FinCEN and, to a lesser extent, BSAAG, remain as critical components of the regulatory architecture through which the AML regime is carried out today.

This era also highlighted challenges that remain core to AML in practice. Although lawmakers initially focused their attention just on banks, it soon became clear that the more they scrutinized transactions that flow through the banking system, the more laundered funds might find ways to move outside of that system. Congress sought to mitigate these disparities over time and in various ways. The Money Laundering Suppression Act, passed in 1994, was among the most important steps in this regard. It expanded and standardized the obligations placed on all money services businesses (MSBs), required all MSBs to register with FinCEN and made it a crime to run an unauthorized MSB.

In practice, this meaningfully helped to reduce but far from eliminated the asymmetries between the AML expectations effectively placed on banks relative to MSBs. FinCEN has delegated its supervisory authority over MSBs to the IRS, while retaining enforcement authority. Reports suggest that apart from tax-related matters, IRS supervision is far from effective and enforcement tends to be delayed and quite limited.<sup>12</sup> For banks, by contrast, the bank's primary regulator and supervisor also has authority to supervise the adequacy of the firm's AML compliance. Although banks also make meaningful mistakes, the far more robust oversight translates into higher investments in AML compliance and a seemingly higher level of compliance.

At least two other features of AML were also influenced by its close relationship, in the early decades, with the War on Drugs. The first dynamic is that it may have been used to over-penalize relatively low-level drug offenders. As has now been more widely recognized, the War on Drugs imposed significant and suboptimal social costs, contributing to mass incarceration at levels far beyond otherwise comparable countries.<sup>13</sup> Then-law professor Tino Cuellar has shown that a primary impact of AML laws during the 1990s was to accentuate the excessive criminalization of the era, as AML violations were often added to otherwise low-level drug offenses in ways that resulted in substantially longer sentences.<sup>14</sup> Much has changed in the nation's drug, incarceration and AML policies since that time,

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<sup>12</sup> Treasury Inspector General for Tax Administration (Sept. 28, 2018), at 4.

<sup>13</sup> Human Rights Watch (2000).

<sup>14</sup> Cuellar (2003).

but the episode reflects the ways that AML can accentuate both good and bad approaches to policymaking and law enforcement.

The early focus on the War on Drugs also shaped the limited international coordination that existed. In the Money Laundering Control Act, for example, Congress admonished Mexico to enter a treaty with the United States, giving U.S. officials greater ability to access and use information about money laundering through Mexican banks. Similarly, when the Financial Action Task Force (FATF)—the primary international body promoting AML coordination—was created in 1989, its primary aim was to further address the “devastating” impact of the “drug problems” of the day.<sup>15</sup> Although FATF has grown far beyond these roots and now serves as the leading international organization on AML, the origins of any institution can have long-term effects on its culture and priorities.

## **B. War on Terror**

The AML regime, domestically and abroad, was transformed after the terrorist attacks of September 11, 2001. With the adoption of the USA PATRIOT Act (“Patriot Act”) and the advent of a new “War on Terror,” AML obligations became more pervasive and far-reaching. Affirmative obligations that banks had staunchly resisted, such as customer due diligence, passed and were implemented without meaningful resistance. The United States also initiated a much more comprehensive effort to compel other jurisdictions to adopt and enforce their own AML regimes.

One of the biggest shifts post-9/11 was the introduction of combatting the financing of terrorism (CFT) as a central aim of AML, both in the United States and internationally via FATF. Following through on recommendations made by the 9/11 Commission Report, the hope was to use the infrastructure that had been designed primarily to identify illicit gains to now detect funds being directed to facilitate terrorist activities.<sup>16</sup> This is a very different type of aim, even though it also requires information about the flow of funds.

The new statutory regime also imposed compliance regime obligations on a wider array of businesses facilitating the flow of funds; it imposed enhanced due diligence procedures in connection with foreign correspondent bank accounts; it sought to promote information sharing, among government agencies and among banks; and, it increased both the civil and criminal penalties for money laundering. Commensurate with the longstanding feature of vesting significant discretion in the Treasury Secretary, the Patriot Act authorized the Secretary to impose “special

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<sup>15</sup> G7 (Jul. 7, 1989), at para. 52-53. *See also* FATF, *History of the FATF*.

<sup>16</sup> National Commission on Terrorist Attacks Upon the United States (2004), at 382.



measures” on jurisdictions, institutions or transactions that are of “primary money laundering concern.”<sup>17</sup>

As with other features of the Patriot Act, the framing around the War on Terror enabled developments that would not have been possible otherwise. For example, in expanding the liability shield for entities filing suspicious activities reports (SARs) and strengthening the confidentiality obligations regarding the filing and use of SARs, the Patriot Act tilted the scales in favor of robust AML and against transparency and privacy.<sup>18</sup>

The policies adopted by Treasury and other U.S. actors following the Patriot Act also contributed to increased adoption and (often to a lesser extent) implementation of AML regimes in countries across the world. Concerns about terrorism and corruption contributed to increasing international pressure via FATF and other international organizations, such as the International Monetary Fund, Transparency International, and United Nations Convention Against Corruption, along with the United States in active advocacy for change.<sup>19</sup>

### **C. Recent Developments and Trends**

For almost two decades thereafter, the statutory scheme governing AML remained static, although regulations, enforcement and practice continued to evolve. For example, illustrating the breadth of flexibility AML laws vest in the Treasury Department and perhaps illustrating why such flexibility is justified, FinCEN took significant steps to address the challenges arising from the use of shell corporations by requiring financial institutions to engage in due diligence to identify beneficial owners when opening an account for certain legal entities.<sup>20</sup> The Treasury also used the breadth and flexibility of its authority in early efforts to address AML risks associated with the rise of cryptocurrencies. In 2013, FinCEN issued guidance clarifying that existing AML obligations applied to “convertible virtual currencies” (CVCs).<sup>21</sup> In practice, the level of compliance seems to have remained quite low for years after that guidance was issued, likely because of limited enforcement.<sup>22</sup>

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<sup>17</sup> USA PATRIOT Act of 2001, Pub. L. No. 107-56, 115 Stat. 272.

<sup>18</sup> Goux, Egan & Citrin (2008).

<sup>19</sup> See, e.g., IMF (2023); Transparency International, *Our Story*. For further background on the importance and costs of corruption, see United Nations Office on Drugs and Crime, *Convention on Corruption*.

<sup>20</sup> See 31 C.F.R. pts. 1010, 1020, 1023, 1024, and 1026; Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 91 (May 11, 2016).

<sup>21</sup> FinCEN (Mar. 18, 2013).

<sup>22</sup> Subsequent enforcement actions have cracked down, but only after it became clear how mixers were being abused to facilitate cyberattacks and other unlawful activity and were being used by sanctioned actors. See Department of the Treasury (Aug. 23, 2023); Department of the Treasury (Aug. 8, 2022).

Another noteworthy change is that much of the recent enforcement involving cryptocurrencies has been spearheaded by Treasury’s Office of Foreign Assets Control. This reflects the overlap of the infrastructure used for AML and sanctions purposes. Although economic sanctions have a long history that often stood apart from AML, the compliance infrastructure that financial institutions and other entities use to comply with (or flaunt) AML obligations is often what they also utilize to comply with sanctions obligations, particularly as those obligations have been used to target individuals and affiliated entities. Although less discussed here, sanctions-related concerns may well be the more pressing policy consideration in the years ahead.

Another notable development is the dramatic and continual increase in the number of SARs filed with Treasury each year. There were 3.6 million SARs filed in 2022, up from 1.7 million in 2014, 280,000 in 2002 and just over 60,000 in 1996.<sup>23</sup> While some of this is due to increased filing obligations for non-banks, even banks are filing SARs at much higher rates. Whether this reflects a tendency to file excessive, defensive, low-quality SARs or reflects increases in fraud and expanded use of technology enabling greater levels of detection is difficult to discern from the data available. Limited empirical evidence suggests that the volume may be counterproductive at this stage, but it is possible that technology could enable more effective analysis of soft signals, thus supporting more expansive reporting.<sup>24</sup>

The total costs can be hard to measure, particularly as AML compliance is often embedded as part of a broader compliance regime within financial institutions. An oft-cited annual survey by LexisNexis suggests that the total cost of financial crime compliance across financial institutions worldwide was \$274 billion in 2022, up from \$214 billion in 2020, with the great bulk of this cost incurred by institutions based in North America and Europe.<sup>25</sup>

The mounting costs of complying with AML coupled with evidence that the regime may not be achieving as much as it could or should (discussed further below) prompted Congress to adopt reforms in 2021. Adopted as part of the National Defense Authorization Act, the Anti-Money Laundering Act of 2020 (AMLA) is a

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<sup>23</sup> FinCEN, *Suspicious Activity Report Statistics*; FinCEN (June 2009). Quantitative data about the volume of SARs filed, and by whom, is readily available on FinCEN’s website. For more than a decade, ending in 2013, FinCEN posted a semiannual newsletter, SAR Activity Review—Trends, Tips and Issues, “the product of a continuing collaboration among the nation’s financial institutions, federal law enforcement, and regulatory agencies to provide meaningful information about the preparation, use, and utility of Suspicious Activity Reports (SARs)” which provided a rich compilation of recent qualitative and quantitative trends and included case studies of how certain SARs had been productively used to promote law enforcement and related aims. Some of this information is still now provided in other forms.

<sup>24</sup> For a discussion of how more SARs may be counterproductive, see Unger & van Waarden (2009).

<sup>25</sup> LexisNexis Risk Solutions (2022).

wide-ranging piece of legislation that includes efforts to address deficiencies in the current regime and efforts to ensure that obligations are imposed in ways that further policy aims.<sup>26</sup> A centerpiece of AMLA is the requirement that FinCEN develop a new beneficial-ownership database, which it is attempting to implement in significant part by imposing new reporting requirements on companies. AMLA also sought to promote the efficiency of the AML regime in practice, to promote the use of technology to enhance efficiency and efficacy and to require regulators to articulate priorities.

AMLA embodies a host of revisions designed to enhance the functioning or reduce the costs of the current regime, but it makes little effort to re-imagine the contours or design of that regime.<sup>27</sup> More generally, although there have been good faith efforts to implement AMLA, there are already significant questions about whether the actual implementation will enable the hopes many had pinned on AMLA's passage.

Finally, it is worth noting that the logic for the various AML rules that are imposed on banks are not rationalized, as is usually the case, as correcting a market failure. Some elements of the regime could be explained in these terms. For instance, neither individual regulators nor firms will internalize the society-wide benefits from rooting out corruption or promoting the overall integrity of the financial system. It follows that boosting the incentives to consider these effects could be warranted under the traditional paradigm. But inherent in the notion of trying to correct a market failure is an assumption of some optimal outcome that would be achieved but for the market failure. There is no such readily available baseline for AML. The myriad objectives of AML and the types of costs associated with today's AML regime (from the pecuniary costs imposed on institutions to the civil liberties interests) make it impossible to construct an obviously optimal baseline. Using the frame of seeking to correct market failures will not work. Acknowledging this limitation may help to explain why traditional tools (e.g., using fines to better align incentives) have not been as effective as one might hope.

## **II. ASSESSMENT OF THE CURRENT SYSTEM**

In order to assess the current system, a good starting point is to ask what objectives it seeks to achieve and how well it is accomplishing those objectives.

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<sup>26</sup> For an overview, *see* Rosen & Miller (2022).

<sup>27</sup> Other features of AMLA include expanded subpoena authority for law enforcement, additional penalties and obligations for politically exposed persons providing information to financial institutions, expanded rewards and protections for whistleblowers, further expansions with respect to the types of businesses covered (including antique dealers and further obligations with respect to virtual currencies).

Although simple to state, neither question is easy to answer. This part thus seeks to tackle those questions from a number of different vantage points, with each perspective providing additional but incomplete insights into just how well the system is currently working. It begins by using a counterfactual to explore the benefits of the current AML regime. It then shifts to other frames, however, that suggest a number of significant shortcomings. The final subsection explores how the very process of developing better metrics for answering these questions might enhance efficacy and accountability relative to the status quo.

### **A. Counterfactual**

One way of assessing today's AML regime is to consider what the world might look like had policymakers never gone down this road. This type of counterfactual inherently requires speculation, and this challenge is accentuated here because of the laws precluding law enforcement and others from disclosing when and how they use BSA data. Nonetheless, this type of exercise can play a crucial role in benchmarking the current system and noting accomplishments that might otherwise be taken for granted.

For example, starting in 2018, the Government Accountability Office (GAO) undertook a broad audit of the AML regime that focused, in part, on how law enforcement uses the BSA data that comes out of today's AML regime. The GAO surveyed a generalizable sample of more than 5,000 personnel at six agencies that are the biggest users of the FinCEN BSA database (Immigration and Customs Enforcement Homeland Security Investigations, the Secret Service, the Drug Enforcement Administration, the Federal Bureau of Investigation, U.S. Attorneys' Offices, and the IRS Criminal Investigation) about their use of BSA reports from 2015 through 2018.<sup>28</sup> The GAO found personnel at each of the agencies "using BSA reports extensively to inform investigations and prosecutions." At all six agencies, the majority of respondents reported using BSA data to start or assist new investigations and 72 percent of respondents reported using BSA data to conduct or assist with existing examinations.

Individual agencies have also at times provided aggregated information showing how much they rely on BSA data. In 2023, for example, IRS Criminal Investigation reported: "Over the past three fiscal years, more than 83% of IRS-CI criminal investigations recommended for prosecution had a primary subject with a related BSA filing. Convictions in those cases resulted in average prison sentences of 38 months, \$7.7 billion in asset seizures, \$256 million in restitution, and \$225 million in asset forfeitures."<sup>29</sup> As of the end of 2021, the Department of Justice's

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<sup>28</sup> Government Accountability Office (2020).

<sup>29</sup> IRS (Jan. 18, 2023).

Kleptocracy Asset Recovery Initiative had recovered and assisted in recovering and repatriating approximately \$1.7 billion in assets; the Initiative had also restrained \$2.2 billion in additional assets pending litigation and return negotiations.<sup>30</sup> More generally, regular publications such as the National Money Laundering Risk Assessment, last issued in 2022, bring together insights and perspectives from across the myriad agencies involved in AML and consistently include numerous case studies of how law enforcement successfully uses BSA data to facilitate a range of law enforcement activities that address drug trafficking, human trafficking and cybercrime in the latest report.

The GAO Report, National Money Laundering Risk Assessment and other official accounts also suggest meaningful opportunities for improving how law enforcement uses BSA data, so nothing here suggests optimality. Nonetheless, the information available suggests that without the current AML regime, law enforcement would be both more costly and less effective at identifying and prosecuting criminal activity.

Trying to develop counterfactuals with respect to the other functions of AML is even more challenging, but again, the evidence suggests that the current regime is somewhat effective. For example, when the United States and other countries opted to make economic sanctions—against not just Russia but also Russian oligarchs—a central plank of the response to Russia’s invasion of Ukraine, the capacity of financial institutions to use their AML compliance infrastructure likely enhanced the capacity to respond in a timely and helpful manner. Similarly, the Treasury Department could and did leverage its relationships with financial institutions to accelerate and consistently revise its response and guidance. For example, in late 2022, FinCEN put out a Trend Analysis that initially analyzed 7,000 BSA reports, revealing 454 that detailed transactions linked to Russian oligarchs, high-ranking officials and sanctioned individuals. The majority of those 454 filings had specifically referenced earlier guidance issued by the agency, suggesting that the regular bulletins the agency had issued providing timely guidance may have helped financial institutions in identifying relevant and reportable transactions. In analyzing those filings, FinCEN was able to provide material information useful to enforcing the sanctions in place and to provide further guidance to entities with BSA obligations about the type of behavior—from the use of shell companies to wire transfers to children to efforts to move high-value assets—through which sanctioned parties were attempting to evade sanctions.<sup>31</sup>

FinCEN and other agencies were also able to harness existing relationships with counterparts abroad to far more quickly and comprehensively develop the

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<sup>30</sup> Department of the Treasury (2022), at 25.

<sup>31</sup> FinCEN (2022).

international network needed given the sophistication and global reach of the parties subject to the sanctions. By March 2023, the Russian Elites, Proxies, and Oligarchs (REPO) Task Force—which included the United States, the EU and other significant jurisdictions—had “leveraged extensive multilateral coordination to ... successfully block[] or fr[eeze] more than \$58 billion worth of sanctioned Russians’ assets,” and “heavily restricted sanctioned Russians from the international financial system.”<sup>32</sup>

The AML infrastructure was merely one component of the myriad tools brought to bear on this effort, and the overall efficacy of the sanctions program remains uncertain. There are also questions about just when and to what extent it is appropriate to use sanctions against individuals that are not formally part of a state government. Nonetheless, as with law enforcement, the evidence available suggests that the AML infrastructure, broadly construed, has become a tool of statecraft that expands the option set of possible responses that the U.S. government and others can deploy in what seem likely to be ongoing efforts to navigate a challenging geopolitical landscape.

Overall, there is no doubt that the current regime clears the bar of making a difference in deterring crime and furthering the objectives of the U.S. government. This observation leaves open, however, the bigger question of how well the system actually functions. The next several sections provide alternative ways of answering this question.

## **B. Proportion of illicit funds captured**

A simple way to assess the efficacy of today’s AML regime would be to examine the proportion of illicit money that is seized as a result of AML. Maximizing the capture of illicit funds could be an aim in and of itself or a means of achieving other aims, such as raising the probability of seizure, making it more likely that an AML regime is helping to reduce crime and terrorism via both detection and deterrence. This metric has the advantage of being well-defined and easily explained to policymakers and the public, even if not all that easy to measure.

By this metric, the system is performing abysmally. A more-than-decade-old but still widely-cited estimate by the United Nations Office on Drugs and Crime suggests the current regime captures a mere 0.2 percent of illicit money flows.<sup>33</sup>

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<sup>32</sup> Department of the Treasury (Mar. 9, 2023).

<sup>33</sup> United Nations Office on Drugs and Crime (2011), at 7.

Other estimates are higher, but the *highest* estimate, from a 2016 Europol report, suggests 1.1 percent of illegal activity was detected.<sup>34</sup>

Despite its simplicity, making the level of seizures the objective has several limitations. A threshold challenge is that all of these estimates are inherently coarse, as even though the amounts seized can be known, estimating the amount of illicit economic activity requires a good deal of conjecture. Each effort to try to develop this metric seems to have run into difficult and important questions about where illicit funds are being generated and how they are moving through the system. Without this information, it is hard to make judgments about which options for potentially changing the system would be most effective.

Focusing primarily on the amounts captured—the more reliable figure—could be even more misleading. If the system is very ineffectual there could be vast amounts of illicit activity taking place with only a small percentage being detected, and yet large sums being captured. Conversely, if the system is very effective and deters activity little would be captured.

The incredibly low estimates on the proceeds being captured currently suggest significant room for improvement no matter what the aim of AML. Continuing to improve and share data on capture rates is helpful in making sure this point is not lost. Nonetheless, without a reliable way to estimate the volume of undetected, illicit funds, this framing of the objective provides at best a partial measure of efficacy.

### **C. Leaks and External Evidence**

A very different approach to assessing the efficacy of today's system is to forego any effort to be comprehensive and instead draw inferences from information inadvertently made public via various types of leaks. Given that money laundering by its nature is opaque and much of today's AML regime operates behind a shroud of opacity, leaks can provide valuable insights into just how much money is being laundered and how well today's AML regime is performing. The ad hoc and sometimes opportunistic nature of leaks limits their utility as a summary metric, but ignoring how much has been learned about today's system through leaks would be absurd.

Even a cursory look at two recent leaks provides further evidence that the current AML regime leaves much to be desired. The first, commonly known as the Panama Papers, involved a German newspaper obtaining access to more than 11 million leaked encrypted confidential documents belonging to Panama-based law firm Mossack Fonseca in 2016. Although the massive cache revealed that people use shell corporations for myriad, and sometimes legitimate reasons, it also revealed significant tax evasion and weaknesses in AML regimes the world over. The leak

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<sup>34</sup> Europol Criminal Assets Bureau (2016), at 4.

triggered investigations in more than eighty jurisdictions, has already enabled the recovery of at least \$1.36 billion in back taxes and penalties across 24 jurisdictions and led to criminal investigations and prosecutions.<sup>35</sup> This leak also affirms, and helps shape, the legislative and regulatory efforts to collect more robust information about beneficial ownership by showing just how common (and misused) shell corporations are, absent more robust efforts.

A smaller, subsequent leak raises even more pressing questions. In 2020, reporters got access to more than 2,500 FinCEN documents, mostly SARs. The incident raised two types of issues. First, it elevated concerns about the capacity—technological and otherwise—of FinCEN and others with access to BSA data to maintain the confidentiality of that data. This commitment is critical to the integrity and functioning of the current system. Second, the substantive information leaked made clear that five of the largest global banks had meaningful deficiencies in their AML compliance regimes.<sup>36</sup> Prudentially regulated banks may be doing a much better job than many nonbank financial companies when it comes to AML, but even they are far, far from perfect.

There is also information via other channels that further supports the conclusion that the current regime is far from optimal and has important gaps. For example, when the IRS established an Offshore Voluntary Disclosure Program in 2009 to encourage taxpayers to disclose any offshore accounts, assets or income in exchange for reduced penalties, the results were stunning. In the years that followed, more than 100,000 taxpayers used the program, and related IRS initiatives, to disclose secret offshore accounts, producing more than \$11 billion for the United States in back taxes, interest, and penalties.<sup>37</sup> This figure, which may be well shy of the actual amount of tax evasion that had otherwise gone undetected, is both a testament to the economic value of a well-run AML scheme and a reflection of just how much money often has been squirreled away without detection under the regime as it has been operating. Subsequent legislation and improvements in AML compliance in other jurisdictions should have reduced tax evasion in recent years. But, as is commonly the case when it comes to illicit activity, baseline rates are not readily available and not likely to become so.

#### **D. Third-party Assessments**

The analysis thus far suggests that today's AML regime is doing a lot of work helping law enforcement and as a broader tool of statecraft, but it is also falling far short of what it potentially could and should be able to achieve. Having established this foundation, it is useful to look at the more formal mechanisms currently used to assess the efficacy of AML regimes in the United States and elsewhere.

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<sup>35</sup> McGoey (Apr. 6, 2021).

<sup>36</sup> International Consortium of Investigative Journalists (Sept. 20, 2020).

<sup>37</sup> IRS (Sept. 4, 2018).



The most prominent external assessments come from FATF. FATF regularly undertakes country-specific assessments of how well each country’s AML regime aligns with FATF principles. The last FATF evaluation of the United States was issued in 2016, and partially updated in 2020.

FATF judges that the United States performed reasonably well, albeit far from perfectly, with respect to both technical compliance and actual effectiveness. Appendix A, reproduced from the FATF report, shows where the United States shines, and where it falls short—at least on FATF’s terms—as of the date of the assessment. A quick glance at the consolidated assessments of all countries reveals a patchwork—with some countries performing better than others but with no jurisdiction achieving consistently outstanding performance across categories.<sup>38</sup>

In the qualitative assessment, FATF recognized that the “global dominance of the U.S. dollar,” coupled with the “unique scope, openness and reach of its financial system globally,” makes the United States an attractive venue for laundering.<sup>39</sup> Overall, FATF found that “[t]he AML/CT framework in the U.S. is well developed and robust. Domestic coordination and cooperation on AML/CFT issues is sophisticated” and shows ongoing maturation. FATF further found that most financial institutions (here, seemingly referring to banks rather than to other types of money services businesses) have “an evolved understanding of ML/TF risks and obligations, and have systems and processes for implementing preventive measures, including for on-boarding customers, transaction monitoring and reporting suspicious transactions.”<sup>40</sup> Finally, the report applauded the capability of law enforcement, though in focusing on statistics such as the number of AML charges brought, the assessment could well have been celebrating what commentators such as Cuellar suggest is an overall tendency toward excess criminalization in the United States. Aggregate figures say little about who is being prosecuted and why.

At the same time, FATF did find numerous deficiencies in the U.S. regime. The lack of timely, accurate beneficial ownership information was identified as a major gap in 2016, albeit one that the United States is trying to address. FATF also recognized that the rigor of the AML regime varies massively by sector; at the time, it suggested there were too few obligations imposed on investment advisers, lawyers, accountants, real estate agents, many trust and company service providers and (with some exceptions like casinos) designated non-financial businesses and professions. FATF provided numerous examples suggesting that the vulnerability of these sectors substantially weakened the overall regime. It also helpfully identified

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<sup>38</sup> FATF, *Consolidated Assessment Ratings*.

<sup>39</sup> FATF (2016), at 5.

<sup>40</sup> *Id.* at 3.

other concrete shortcomings, noting, for example, that the U.S. regime “would benefit from ensuring that a range of tax crimes are predicate offenses for ML.”<sup>41</sup>

A related challenge in deciding how much weight to put on the FATF reports is that it is not the “United States,” nor other countries at the table at FATF, but often representatives who are themselves deeply enmeshed in the current AML ecosystem. This comes through in the very design of the assessment, which has forty different principles, and no hierarchy among them. This is not the type of grading system that is conducive to being understood by outsiders. Just as importantly, the membership composition of FATF includes numerous regimes that may place far different values on civil liberties and on promoting broad access to financial services than the United States.

Other assessments—less official, but potentially more able to be honest as a result—provide a harsher assessment of the United States. Most notably, the Tax Justice Network ranks the United States as #1 on its Financial Secrecy Index.<sup>42</sup> As of 2022, Switzerland is #2 and others in the top ten include Singapore, Luxembourg, Japan, United Arab Emirates, Germany and Guernsey. A significant factor contributing to the dismal ranking of the United States comes from the vulnerability of the United States arising from the role the dollar plays in international transacting, but much of it is also a byproduct of the high degree of opacity around corporate and trust ownership. Cutting through some of the nuances that may be justified in official sector measures such as those put out by FATF, the weighted metrics used by Tax Justice Network bring into vivid relief the way the United States has fallen short: It massively reduces transparency at the bank level (in contrast to places such as Switzerland) but guts the impact of that regime by allowing so much opacity at the level of legal entities. Although also less than perfect, these types of third-party assessments provide both information and accountability, free from the bureaucracy of formally constituted international organizations.

Overall, the various third-party reviews also suggest that the U.S. AML regime is uneven in its efficacy and has some clear areas that can be improved.

## **E. Putting the Pieces Together**

Combining these various attempts at assessing the system together suggests a number of lessons. First, the AML regime as it has evolved seems far from optimal by just about any metric. Some of the shortcomings may reflect tradeoffs,

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<sup>41</sup> *Id.* at 4.

<sup>42</sup> Tax Justice Network, *Financial Secrecy Index 2022*.

but there appears to be meaningful room for improvement in many areas without having to confront the difficult tradeoffs that, at some point, are inherent in AML policy choices.

Second, the AML/CFT and sanctions regimes now in place are not conducive to being evaluated using a single, simple summary statistic. At best, it would be summarized by *several* complementary measures. Each reveals some insights that others do not. And, the data challenges accentuate the value of using a multi-pronged approach that couples both empirical and qualitative measures. There have also been other valuable, albeit necessarily incomplete, efforts to bring more rigor to these analyses than discussed here.<sup>43</sup> Overall these types of efforts may raise the pressure on the governance mechanisms around these regimes and the importance of ongoing communications around infrastructure of common interest.

Third, the measurement challenges in quantifying some of the potential aims are substantial. Attaching numbers to many of the objects of interest would be very, very hard. Traditional cost/benefit analysis, even when nested, requires these kinds of numbers so that tool will be of limited value in this context. Such efforts may well themselves be cost justified, as efforts to measure can reveal strengths and weaknesses in the regime and where there may be frictions impeding helpful information exchange. But the measurement challenges are sufficiently large and embedded that they cannot be assumed away in any effort to improve how the regime functions or to enhance accountability.

Fourth, in line with the evolution of the system documented in Part I, the importance of different objectives probably varies over time. Law enforcement objectives change and geopolitical conditions vary. These fluctuating priorities have implications for system design (discussed below), but the dynamism also suggests that it will be important to have an evaluation system that can adapt to changing circumstances.

Fifth, a more promising approach may be to identify core aims and consider how the AML regime is performing against those core aims. For example, among the most commonly cited aims of AML are: (1) facilitating domestic law enforcement to detect, prosecute and ideally deter crime; (2) detecting and deterring corruption, which may be the aim most easily expanded to incorporate other foreign policy aims; (3) combatting the financing of terrorism (CFT); and (4) promoting the integrity of the financial system. A different way of assessing whether the system is performing well would be to try to develop metrics for how well the system is promoting each of these distinct aims.

This type of exercise would be particularly useful if carried out by the public sector, for a number of reasons. First, it would force greater clarity about the aims, and would force the public sector to frame those aims in ways that could be

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<sup>43</sup> For example, the Central Bank of the Bahamas regularly holds a conference promoting this type of research and engagement around these issues. See Central Bank of the Bahamas, *A Global Reference Resource for Empirical AML Research*.

conducive to measurement. Relatedly, it would require the public sector, broadly speaking, to develop more robust measurements for assessing whether it is achieving given aims. Although there are a number of modest steps in this general direction embodied in AMLA, measurable outputs are a significant step further. In recent years, researchers have become increasingly clever at using the data available to draw inferences about activity and outputs that are not directly observable. Although AML may never escape a challenge with establishing baselines, e.g., how much crime or tax evasion would occur but for the AML regime, putting robust efforts at measurement into place could help yield valuable insights into changes in bank practice, policy or technology that may be having an effect. More generally, having to devise and report these types of metrics could enhance accountability and promote public dialogue in ways that are sorely lacking in the current regime.

Finally, AML should be viewed somewhat differently than other financial regulations in terms of its rationale. As we have seen, it is hard to neatly tie its aims to the kind of familiar externalities that most financial regulations seek to address. Also, in some instances, it is unclear if the rules are even the most targeted (or maximally effective) option for advancing a policy goal. These conclusions may not be surprising given the ad hoc evolution and the time-varying priorities, but they are worth keeping in mind when considering blue-sky reform possibilities.

### **III. IMPLICATIONS**

Having looked back to understand how the United States ended up with the AML regime now in place and then having assessed the system's efficacy, the challenge becomes how to lay the groundwork for a better road ahead. This Part proposes two complementary frameworks for understanding why and where the current regime is falling short, and it explores some of the policy implications that flow from mapping the current scheme onto these frameworks. The result is eight principles that can serve as guideposts for both incremental reforms, of the type that have been pursued traditionally, and more radical reforms, which this paper suggests may be warranted.

Looking at the significant shortcomings in the current regime alongside the massive resources being poured into it suggests room for significant improvement. The incredible path dependence of the current regime, both in terms of aims and design, helps to explain why there may be room to meaningfully enhance outcomes with relatively modest, or at least manageable, reforms. AMLA is a step in the right direction, but its scope is partial relative to the issues at play and implementation thus far appears mixed. The aim is not to provide yet another laundry list of the type embodied in AMLA or of the kind that might appear in the next FATF mutual assessment, but rather to zoom out far enough to provide a more holistic framework for understanding shortcomings and opportunities.

Taking a holistic perspective on these issues means recognizing the historical dynamism in the policy aims central to AML as endemic to the regime and

exploring the implications for enforcement. It also provides a principled way to think about the compromises that may be required in the short run to more effectively harness the gains that technology can provide in the long run. Using a holistic frame to look horizontally across the system helps reveal how allowing any domain (or, perhaps, any jurisdiction) to fall too far out of line with others can undermine the work and investments being invested elsewhere in the system. It also provides a frame for exploring how best to harness the relative (sometimes, unique) competence of various actors in what is a complex private-public ecosystem. And the holistic framework highlights the importance of assessing the relative impact of the marginal dollar spent across different parts of that system.

### **A. System evolution**

Two of the lessons from the historical review are that the objectives of the system and technology that is used to launder and detect laundering have changed over time. This sort of evolution seems destined to continue. A third lesson is that many of the responses took a static view by asking how the existing system should be patched to deal with the problem at hand. Put differently, prior to AMLA, most of the changes to the system did not contemplate the continued evolution of the system and therefore did not include any analysis of whether a restructuring would have superior returns over the medium-term relative to a quick fix.

These observations lead to the first two principles that would be embedded in a more effective system.

**Principle 1:** When faced with a new threat or pivoting priorities, proposed responses should include an assessment of whether restructuring the current system, or investing in new infrastructure, would be the best option for improving the system over the medium term. By implication, this would amount to admitting that tolerating a less effective system in the short run might be needed to deliver a better set of longer-run outcomes.

As a practical matter, the exigencies of the circumstances will sometimes make it difficult to prioritize a longer-term perspective. When Russia invaded Ukraine, the decision to use economic sanctions as a key component of the international response, for example, required the United States and other countries to work expeditiously to implement, learn and revise restrictions as quickly as possible and to be as effective as possible, subject to agreed-upon limitations. In such circumstances, this principle should not operate as an impediment but it should instead inform the steps regulators and others take as the exigencies give way.

For example, best practices may require a systematized review of what was done, the impact of the actions taken and any collateral or other consequences of note. Such exercises, undertaken by both domestic authorities and ideally undertaken separately by a consortium of the countries or other engaged entities could lead to fewer subsequent patches, quicker adjustments when patches are

necessary and more consideration of alternatives when any initial responses are undertaken.

**Principle 2:** When faced with a new threat or policy priority, proposed responses should be evaluated in part based on whether they will make the system more (or less) rigid in the future. This is essentially the converse of the first principle. If an objective is added (or some other change is made), it should in part be judged recognizing that if it reduces future flexibility (or adaptivity) that is a cost. Likewise, if a solution creates flexibility and might make the system more nimble in the future, then that benefit should be taken into account.

There is likely a tendency in the current system to say that every proposed change is essential and urgent, so there is never a good time to move in a new direction or to invest in new approaches. Yet, the challenges from implementing many of the sound reform suggestions in AMLA highlight the difficulty of retrofitting infrastructure once it is in place. This principle seeks to create an off-setting force in the system by recognizing the costs of proposals that foreclose future options or make them more costly to adopt.

One way to make both principles more operational would be to conduct periodic blue-sky assessments of the system. The assessment could ask whether the amalgam of rules actually functions coherently and effectively or whether a bigger reform and re-think is needed. Likewise, if an emergency measure had been undertaken, the review could create a way to look for unintended consequences such as creating additional rigidities that could be addressed and/or if appropriate technological solutions have been fully explored. In each instance, success may hinge on the composition of the body undertaking the assessment. Those less enmeshed in the current AML regime may bring fresh perspectives and be more apt to engage in broader rethinking.

At the same time, carrying either of these principles into practice would require buy-in from parties directly engaged in the day-to-day practice of running the AML system. Financial institutions, other regulated entities and their supervisors would need to understand how these principles inform and shape what it means to have an adequate risk-based compliance system, and how these principles inform both where resources should be allocated and the types of “mistakes” that should be acceptable to achieve longer-term aims.

## **B. Point-in-time**

Even given its various aims, there are often multiple ways that someone seeking to avoid the AML rules can evade detection and prosecution. This is most obvious with respect to ML, where at different times (and sometimes, at the same time, for different actors) the banking system, crypto assets, real estate, jewelry and art, casinos and trade invoicing have been the preferred alternatives for laundering ill-gotten gains. Likewise, there have always been different ways to structure terrorism financing and the financing of the drug trade. As reflected in the evolution of the AML scheme depicted in Part I, many times the expansions of that

scheme were not the byproduct of changing priorities but instead efforts to close (or reduce) loopholes that either became more apparent or were increasingly used as AML efforts made it more difficult to launder funds using existing channels.

Given the myriad of options, it might seem impossible to come up with priorities for how best to organize enforcement efforts. Because of the collaboration of the public and private sectors in the system, there also will be strong interest from certain parties in shifting the enforcement burden onto other actors. Together these realities make the prospects for ranking priorities appear grim.

Fortunately, there are two countervailing considerations that help with this problem. The first is that those engaged in money laundering primarily care about outcomes, taking cost and associated risks into account. The second truism, which directly follows from the first, is that the weakest link in the system will often be the one that is disproportionately relied upon to launder illicit gains. (This is an oversimplification, of course, given the roles that path dependence, knowledge and the like also play in shaping efforts to bypass AML, but one that holds sufficient truth to be useful for our purposes.)

Michael Freeman and Moyara Ruehsen argue that these ideas can be made operational by looking at five characteristics of competing channels.<sup>44</sup> The first is the volume of funds that can be moved via a particular technique. The second is the risk of having a transaction detected. The third consideration is the simplicity of using a particular strategy. The fourth dimension is the cost (both fees and any bribes) that are required. The final determinant is the speed with which a transaction can be completed. All else equal, channels that allow large sums to be moved, with low levels of detection, that are simple and cheap to implement and that deliver funds quickly will be preferred.

These observations help cut through the fog that might otherwise paralyze any analysis in several ways. For instance, they shift the focus away from the differential burdens that might fall on different entities by emphasizing the importance of outcomes. They also imply that it is essential to consider the incentives and costs of people initiating the transactions—if one domain is more difficult to use apart from AML-related burdens, that changes the baseline of attractiveness and possibly the delta that AML should add to achieve relative parity. Freeman and Ruehsen's five dimensions of ML channels provide a useful way for ranking various strategies and for organizing measurement attempts to compare them. Similarly, recognizing the importance of the weakest link explains why preferred evasion strategies will shift over time, in response to learning, new innovations, new types of opportunity and uneven enforcement.

These observations lead to the next two principles:

**Principle 3:** Authorities may reap outsized gains from focusing on the most significant extant loophole/gap with respect to each of the three big objectives

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<sup>44</sup> Freeman & Ruehsen (2013). For an earlier similar classification, *see also* Maimbo (2003).

(money laundering, drug trade financing and terrorism financing). Because the weakest links will often be the dominant choice for evasion, plugging them should have the highest payoff. Dynamically, this also implies that allowing a new weakest link to emerge and go unattended will prove to be costly, so a relatively small but rapidly growing domain that allows more money laundering merits prompt attention.

There would be several tangible benefits from adopting this principle. Consider the following two examples of knock-on effects. This principle would create pressure to shift measurement efforts towards identifying weak links. Also, communication and reporting would likely become more focused on these areas. These sorts of changes would reinforce the calls in AMLA for a more risk-based and prioritized set of AML efforts.

Recent enforcement actions also reveal how much ML and other illicit flows might have been blocked earlier and with less effort had policymakers adhered to these principles. Most notably, as described above, Treasury used its authority to clarify the application of AML to the crypto ecosystem back in 2013. Yet there were relatively few enforcement actions until recently. This has changed. For example, in November 2023, FinCEN and others entered into a record-breaking settlement with Binance Holdings Ltd. and affiliates valued at \$3.4 billion, and Binance entered a simultaneous settlement of \$968 million. Yet, as Secretary of the Treasury Janet Yellen stated at the time: “Binance turned a blind eye to its legal obligations in the pursuit of profit. Its willful failures allowed money to flow to terrorists, cybercriminals and child abusers through its platform.”<sup>45</sup> The accompanying disclosures more than support Yellen’s characterization but also raise the question of just how much of this illicit financing might have been avoided had policymakers invested more resources earlier to combat the clear weaknesses in the AML regimes implemented by Binance and other large crypto exchanges.

**Principle 4:** Evasion efforts do not respect borders. Borders can create barriers to moving funds, but the barriers are porous—in part because commerce and capital markets are global, so there are many legitimate reasons for moving large amounts of money across national boundaries. Nonetheless, this does mean that outlier jurisdictions can undermine the efficacy of stronger regimes if there are not adequate tools for addressing significant differentials. International cooperation and coordination are essential because the integrity of a domestically focused system will be compromised if there are weak links in other jurisdictions.

There has been significant progress in certain jurisdictions that were the biggest offenders, most notably Switzerland, but the challenge remains a significant one. FATF already plays a central role in helping to promote international convergence and using its assessments to shame and other tools to sometimes penalize jurisdictions that deviate too far from the low standards now acceptable. But there is likely more that it could do, particularly in garnering international

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<sup>45</sup> Department of the Treasury (Nov. 21, 2023).



pressure to bring about improvements. For example, one can see how FATF could bring this principle into its reporting structure. In cases where a loophole in one jurisdiction is creating problems for other countries, the adverse spillover should be pointed out. This could help marshal resources from affected jurisdictions to close these holes. It would also create additional incentives for ensuring minimal levels of compliance and promoting cooperation and information sharing.

### **C. Resource Allocation**

Even if the principles about how the system needs to evolve and how priorities should be set at a point in time are adopted, the question of how resources across the very fragmented regulatory system should be deployed remains. This question is further complicated by the public-private partnership model that characterizes the current system. As reflected in the data on costs, today's AML regime and related compliance obligations imposed on financial institutions impose very significant costs on regulated entities.

It is helpful to split the resource allocation question into two pieces. The first relates to how resources within the official sector are deployed. This question is distinct from a second question about how the responsibilities across the public and private sectors are arranged.

Within the public sector, there are useful insights from other analyses of regulation. A well-established, and robust, principle is that the marginal dollar spent on enforcement should be equated to yield similar gains across activities (or risks). This can be tricky to implement in cases where a resource is shared across domains, but for the most part, the drug trade, terrorism and money laundering enforcement efforts run in parallel (and to a certain extent with separate budgets).

This leads to the next principle.

**Principle 5:** Looking at the myriad federal and state resources devoted to enforcement, budgets (and other resources) should be assessed and gaps considered for reorganizing funding. A benchmark in the reconsideration is that an additional dollar spent should achieve rough parity in terms of enhancing efficacy of the overall regime. A similar effort may be warranted to assess where burdens should be enhanced, reduced or otherwise modified for the range of private actors governed by the AML regime.

Given the caveats flagged earlier about the ability to undertake cost-benefit analyses and the practical realities of moving money among buckets, this recommendation cannot be implemented precisely.

Nevertheless, this principle, when combined with earlier ones, is far from vacuous. Once one recognizes that the weakest link in the system is essentially an approximate summary statistic for the robustness of the system, that recognition suggests an important starting point for allocating public resources. Moreover, the division between resources devoted to domestic monitoring, enforcement and deterrence ought to be compared to the return from improved international

cooperation and coordination, especially involving very weak links that exist outside a country's borders.

Furthermore, this principle carries an interesting implication for potentially measuring the efficacy of the current system. Part II revealed that even though there is no easy way to measure the efficacy and impact of today's AML regime, there could be significant collateral benefits—in terms of both enhancing efficacy and improving accountability—from efforts to develop more robust metrics. Implementing this principle would encourage, and sometimes necessitate, the development and use of such metrics in ways that could promote these twin aims.

Relatedly, many AML reports about the system that focus on gaps in the system (or that evaluate budget allocations) come up with ingenious ways to approximate how much bang for the buck could be achieved by expanding resources for a particular program. For example, the United Kingdom's annual assessment of its AML efforts collects supervisory data on how many desk-based reviews and on-site visits are conducted across the economy on different ways in which money can be laundered and shows the percentage of both types of inspections that find the entities to be non-compliant.<sup>46</sup> Even if such estimates are computed in very different ways, they are all roughly speaking estimates of the marginal return to different policies/actions. Thus, assembling such estimates could provide a novel way to assess the condition of the system. They could also help identify the potential weak links in the system.

Foundational to the current system is the fact that the government outsources many important aspects of reporting and enforcing rules to the private sector. This has some benefits. The cost shifting may be the most obvious benefit from the government's perspective, but there are also other justifiable rationales for this regime. The most common rationale, which does apply here, is that the public and private sectors have different types of information and expertise. Harnessing the relative benefits of each creates possible outcomes that may not be achieved in other ways. As discussed below, this public-private ecosystem may also have distinct benefits—and drawbacks—for aims beyond efficacy.

At the same time, this feature creates other problems. First, the delegation creates incentives for the public sector to push costs onto the private sector. The 2022 total budget for FinCEN, the bureau in the U.S. Treasury responsible for coordinating AML enforcement, was under \$200 million. LexisNexis estimates that compliance costs for U.S. banks in 2022 was over \$45 billion. Congress also tasked FinCEN with leading the efforts to create a database of beneficial ownership of businesses operating in the United States, a task that will consume much of the bureau's resources. Although FinCEN's budget has gone up somewhat to accommodate these demands, it is reasonable to suspect that each marginal dollar industry spends achieves far less than that marginal dollar might achieve if

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<sup>46</sup> See HM Treasury (2022).

appropriately deployed on collective resources, such as the database, or other public parts of the current regime.

The cost sharing also reduces pressure to rationalize the spending that is done inside the government. FinCEN sits at the top of a highly fragmented system. Some of this is by design; other times, it reflects decisions made in other contexts that cannot rationally be altered by AML-related considerations. To the extent this may be a conscious design feature, it may be appropriate to inquire whether redesign rather than just a reallocation of budget may be the better course. At the same time, the question of budget should be considered alongside other efforts to address the frictions that may result from the current arrangements. There may be some benefits from such a regime, discussed below, but this distributed model undoubtedly leads to duplication and extra expenses.

More importantly, this structure leads to substantially different burdens placed on firms offering similar services (or posing similar risks) and different levels of efficacy. The three previous principles would collectively work to reduce this inequity.

They would also move the regime closer to norms embedded in other types of financial regulation. By assessing whether efficacy is being equated across domains, and adjusting budgets and spending to move in that direction the system would be less likely to feature cases where an inefficient tool is being used excessively.

Even assuming burdens are rationalized, there remains a question of how to draw the boundary between the private sector and official sector responsibilities. A general prescription in economics is that it is preferable to assign tasks among different parties based on their comparative advantage in completing the task. In this application, comparative advantage would mean that whichever part of the regulatory system or private sector can deliver a particular outcome at the lowest cost should be tasked with the responsibility for doing so. The importance of adding nonpecuniary considerations to the design challenge motivates the next principle.

**Principle 6:** The system will only work well if it is based on realistic assumptions about the level of resources, capacity, incentives and available information that actually exist.

Making the last two principles operational requires attending to at least three important additional considerations. First is the need to account for the institutional capacity of the official sector and specific agencies within the official sector. For many years, the staffing and budget levels for some of the regulators have been lower than they have requested. So in estimating the outcomes public entities can be expected to deliver, it is imperative to recognize the available funding and their other responsibilities.

Secondly, the partnership model depends on effective information sharing and feedback from the public sector to the private sector about whether the right information is being collected and passed along. The private sector often expresses frustration with the cost that they are expending given the apparently meager

returns. Providing more feedback could both help the private sector see the fruits of their efforts and could mitigate this concern by enhancing the efficacy of the overall system. The GAO and others have previously called for such reforms, and there have been improvements in light of these calls, but the analysis in this paper suggests there remains significant room for improvement. It also highlights the importance of having this feedback structured in ways that enhance usability, particularly given the evolving technological environment. This is the type of issue that will likely require ongoing engagement between various public and private actors.

Finally, the partnership model needs to recognize the potentially conflicting incentives different actors in the system have and the many different public and private actors involved in the current regime. For the private sector, AML is just one regulatory responsibility. The structure of fines for failure to comply will play an important role in shaping how the private sector behaves, but focusing just on the size of fines can be too coarse of a tool for identifying opportunities for improvement. For example, research suggests that compliance officials inside of financial institutions often see themselves as aligned with law enforcement—the agencies that actually use BSA data—but often feel that their work is seen as an expense to be minimized by others in their firms and is often not adequately understood by supervisors—the primary interface with the official sector.<sup>47</sup> Finding ways to build more direct connections among aligned parties may enhance motivation and appropriate, useful information sharing.

Similarly, the various government agencies involved in monitoring and enforcement place different priorities in these activities and in cooperating with other actors in the system. Feedback mechanisms are critical not only between the private sector and the official sector but also among actors in the official sector.

Implementing these two principles in a coordinated fashion could enhance their utility. For example, equalizing the marginal returns of spending within the official sector should encourage the public sector to improve its information sharing and feedback so long as doing so would improve the effectiveness of the system. In addition, if certain parts of the government were not prioritizing AML efforts and this was impairing effectiveness, this would at least be noted. Similarly, if principles regarding the evolution of the system over time were respected, then a reallocation of responsibilities would be encouraged if doing so would improve efficacy. Yet, it is neither certain that these principles will be adopted, nor that if adopted they will satisfactorily deal with these concerns.

These principles could also form the basis for renegotiating responsibilities and could help generate a reorganization that does not necessarily start from the status quo. The aforementioned blue-sky systemic review could also evaluate whether the balance of responsibilities both within the government and between the

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<sup>47</sup> See, e.g., Eren (2021).

public and private sector is such that the system can work well (given the actual levels of resources, capacity, incentives and available information.)

#### **D. Tradeoffs**

Collectively, reforms to the current system that bring it more in line with the first six principles would greatly improve it. Nonetheless, there are still difficult questions about how far regulation and enforcement should and can go in pursuit of their aims. One could imagine an extremely intrusive, draconian system that would stifle financial transactions and make it easier to achieve all of the aims of the current AML system. Alternatively, strip away any right to privacy and one could create a regime that is very effective and inclusive but in which the government can readily monitor every person in the country, and many outside of it.

While these hypothetical benchmarks are useful for making a conceptual point, they are of little practical relevance. The United States and many other jurisdictions are willing to make such tradeoffs, and residents can get very creative when trying to circumvent regimes. Yet, as discussed, such concerns are largely ignored in settings such as FATF. At the same time, there are reasons for concern. This was evident in early Supreme Court cases, and these issues are among the few AML-related topics that are helping to prompt a broader debate.<sup>48</sup> Therefore, based on regulations that have been proposed and enacted or rejected, there are implicit factors that constrain AML efforts. Making these factors more explicit is the first step toward promoting accountability and ensuring that the tradeoffs embodied in the regime are not out of whack aligned with what the public prefers.

The dominant consideration is concern over civil liberties. All advanced economies allow for cash transactions, presumably in part due to the value that people place on the option for transacting anonymously. Debates about privacy are also robust in other domains, particularly as the digitalization of so much activity creates new opportunities for private and public actors to collect and use information. So the right to privacy is clearly a consideration that limits how much information the government should be allowed to collect and what types of transactions should be banned or interfered with.

One critical point is that privacy interests operate along a spectrum. Complete anonymity is one extreme, and one that has been advanced in settings including the rise of cryptocurrencies. But as reflected in people's increasing willingness to use digital payment forms for daily expenses, from getting on a subway to buying a cup of coffee, it is clear that few people expect complete anonymity with respect to their financial activity. Given that AML, by its nature, is inherently inconsistent with efforts to allow complete anonymity, the privacy question is about how much is knowable and by whom.

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<sup>48</sup> See, e.g., Anthony (Oct. 14, 2022); Carrillo (2023).

Cuellar’s concerns about over-criminalization also come into play here. Criminalizing money laundering may be critical to making the regime work as intended, but ongoing attention to enforcement is key to understanding the actual impact of such criminalization.

A second consideration is financial access and inclusion. This captures the ability of all people to access and use financial services. Given that the private sector will bear some of the reporting and enforcement burden, one (rational) response of the private sector is to exclude potential clients/customers for whom the compliance costs exceed the perceived benefits of serving them. Although the use of the term has evolved in recent months, “de-risking” traditionally referred to decisions by financial institutions to cut off clients (or types of clients or services) rather than opt to manage the associated risk.<sup>49</sup>

A glaring example of this issue regards remittances. Immigrants from many countries work in the United States (and other advanced countries) in part so that they can send money back to friends and family. For some countries, aggregate remittances are an important source of income. Yet these cross-border transfers can also be used either to facilitate money laundering or to support terrorism. Because of the weakest link principle, there is a risk that such users will seek the jurisdictions where controls are loosest. Some financial institutions will simply cut off doing business with certain countries or create hurdles so high as to meaningfully limit or even eliminate otherwise lawful transfers.

Other AML-related obligations, such as “know your customer” rules, also increase the minimum level of profitability that a firm needs to anticipate in order to be willing to serve a client. As a result, people with limited wealth, or where the risks they pose exceed the profits they can generate for a bank, may wind up being excluded from the financial system. As recent news reports suggest, when someone is cut off by their bank, they often receive little or no information from the bank about the reason for the decision.<sup>50</sup> This makes appealing the decision almost impossible, and can enhance the frustration.

Hence, the current system faces a “trilemma” in that it is trying to achieve three potentially competing aims. First, the financial system should support civil liberties. Second, the system should promote economic inclusion and access to financial services. Finally, the financial system needs to assist in AML efforts. Removing any one of these objectives would radically change the kind of system that would be possible.

With all three objectives operating, when there is a direct contradiction between the various aims, there is no easy way to resolve some conflicts. Thus the aim is not about drawing optimal lines but ensuring those lines are drawn by the appropriate actors in ways that are consistent with our widely accepted principles. For instance, technocrats should not decide where to draw the line on remittances.

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<sup>49</sup> Department of the Treasury (2023).

<sup>50</sup> Lieber & Bernard (Nov. 5, 2023).

More democratic mechanisms, buttressed by constitutional and other protections, are needed to make these kinds of decisions.

Nevertheless, highlighting the trilemma is a critical step toward appropriate resolution of these difficult and ever-evolving issues, for many reasons. As a starting point, in cases of direct conflict it is helpful to make the tradeoffs transparent. Even absent guidance about how to resolve them, the debates among competing solutions will be better if it is clear what is at stake.

A related benefit of acknowledging the trilemma is that acknowledging the competing considerations can incite democratic engagement around these issues and help identify values embedded in the current regime, even if indirectly.

Structuring such discussions around the trilemma can also illuminate some of the distinct outcomes made possible by the public-private ecosystem surrounding AML. For example, although there may well be reasons to be concerned about how private companies today use information they possess about customers, the privacy interests at stake take on important additional dimensions once information is in government hands. Few would condone law enforcement having immediate access to all of everyone's financial transactions, particularly as the declining use of cash in daily lives means that microdata from our financial institutions can likely provide powerful insights into how, and with whom, people spend their time. Similarly, while many have decried the inefficiency of the decentralization embedded in the current AML regime, which often puts the burden on financial institutions to undertake due diligence rather than (consistently) providing lists and bright lines, this system also reduces the likelihood that people inappropriately denied service by one financial institution are entirely excluded from the financial system.

Finally, framing these tradeoffs as a trilemma may help reveal inconsistencies in how these tradeoffs are resolved in two respects. One is that concerns over economic participation and civil liberties arise in other non-financial contexts and there are well-established laws and norms over how protections are set. For example, medical records are afforded high levels of protection. Likewise, anti-discrimination rules protect people's rights to access various services. The Transportation and Safety Administration trades off its desire to safeguard air travel against the level of intrusion and invasion of privacy it imposes on travelers to achieve that aim. In addition, various parts of the government have established the statistical value of a human life. One could imagine productive discussions about whether the levels of protection relating to financial transactions are calibrated to be consistent with these norms.

Recognizing the trilemma also invites the question of whether tradeoffs between the three competing objectives are resolved in a consistent way within the financial system, especially as the system evolves in light of changing technology. For instance, few would advocate the elimination of cash in order to improve AML objectives (although some people do want to limit very large bills). One way of

conceptualizing this policy choice is that the United States (and most jurisdictions) are willing to compromise on the efficacy of AML—prioritizing instead anonymity and access—but subject to the constraints cash imposes (easier for low-value transactions, need for in-person exchange, etc.). This aim already comes through in some of the proposals in the United States and Europe for a central bank digital currency or digital alternative, and this framing helps explain the virtue of such proposals.

One fascinating aspect of the U.S. regulatory architecture is that the vast majority of the authority for dealing with the tradeoffs associated with the trilemma sits inside the U.S. Treasury. The Under Secretary for Terrorism and Financial Intelligence largely oversees most of the infrastructure related to efficacy. The international dimensions regarding sanctions would run through the Under Secretary for International Affairs. Finally, the Under Secretary for Domestic Finance would have a keen interest in ensuring financial inclusion. Of course, there are also other parts of the government that are also involved; however, many of the most difficult tradeoffs amount to the Secretary of the Treasury having to make judgment calls over how to adjudicate potentially conflicting objectives between the three Under Secretaries. Providing more structure for how these tensions ought to be resolved could be helpful.

Understanding the trilemma leads to two final principles:

**Principle 7:** In cases where the provision of valuable financial services or civil liberties are at odds with AML objectives, fidelity with respect to established modes and degrees of protection should serve as a baseline against which any deviations would need to be explained or justified. This would respect compromises already worked out, while allowing technology to be deployed when it can better promote one of the three values in the trilemma without compromising the other two.

Even when settings are parallel in some regards, there will always be some differences, so judgments are inevitable. But having a baseline can help to provide a check on abuses and serve to illuminate the types of institutions that should be involved in resolving tensions, be it legislatures, courts or other actors. This framing also helps to reveal compromises that may have been made inadvertently as technology changed. For example, the early Supreme Court cases upholding the constitutionality of the key design features of the BSA were handed down at a time when financial information provided far less insight into a person’s actions and acquaintances. Although the legal basis upon which those decisions rest do not credit such an evolution as meriting different constitutional scrutiny, the refusal of the Supreme Court to extend the underlying doctrine to other domains, such as cell phone location data, raises questions about whether a limiting principle should be imposed via other means.<sup>51</sup>

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<sup>51</sup> See *Carpenter v. United States*, 138 U.S. 2206 (2018).



Finally, the last benefit of recognizing the trilemma is that it points to places where reforms might be most beneficial. If one can find aspects of the AML regime where the gains with respect to deterrence and enforcement are small relative to the costs to civil liberties or impingement on economic activity, then those parts of the regime make sense to reconsider.

**Principle 8:** In cases where the ability to meet a given AML objective can be met in various ways, the policy should be selected to minimize the adverse impact on access to financial services or civil liberties.

This principle merely suggests looking for cases where for some reason (most likely due to changing policy priorities or path-dependent evolution) the system creates large burdens with small gains. Once they are identified, a debate should ensue about whether a reform is appropriate. This principle would help partially offset the ratchet tendency that characterizes the current system. It could also help guide the periodic reviews proposed earlier.

Rather than take this approach, most reviews of the AML regime start by looking for loopholes or where there are incomplete rules and trying to remedy these cases. A review of the current regime that focuses on the cases where either civil liberties or economic participation are impeded with little or no AML payoff would be productive and very different from prior reviews.

## CONCLUSION

The current AML/CFT regime in the United States is extraordinarily complex. It has evolved to encompass many aims, involve numerous government actors, rely on a complicated partnership with the private sector and its efficacy is extremely hard to assess. The high cost and often poor performance of the current regime suggest significant rethinking may be warranted. The principles put forward here could help lay the foundation for more wholesale transformation, but could also be used to promote ongoing and still valuable incremental reforms.

Apart from the specific principles set forth, this paper aims to spur a discussion about how the system might be restructured. Given the range of values at stake, and the apparent opportunity for meaningful improvement, the obvious next step would likely be a blue-sky, holistic review of the entire system. Bringing together a diverse range of experts and policymakers to collect further thoughts and perspectives, and to have them compile those views into a more holistic set of reforms could, in the long run, help produce a much more effective and efficient regime. The conversation could also help ensure that the various other values at play are understood and appropriately weighted in efforts to enhance the regime.

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## Appendix A

### FATF Anti-money laundering and counter-terrorist financing measures - United States, Mutual Evaluation Report (2016)

Effectiveness Ratings (High, Substantial, Moderate, Low)

<b>IO.1</b> - Risk, policy and coordination	<b>IO.2</b> - International cooperation	<b>IO.3</b> - Supervision	<b>IO.4</b> - Preventive measures	<b>IO.5</b> - Legal persons and arrangements	<b>IO.6</b> - Financial intelligence
<b>Substantial</b>	<b>Substantial</b>	<b>Moderate</b>	<b>Moderate</b>	<b>Low</b>	<b>Substantial</b>
<b>IO.7</b> - ML investigation & prosecution	<b>IO.8</b> - Confiscation	<b>IO.9</b> - TF investigation & prosecution	<b>IO.10</b> - TF preventive measures & financial sanctions	<b>IO.11</b> - PF financial sanctions	
<b>Substantial</b>	<b>High</b>	<b>High</b>	<b>High</b>	<b>High</b>	

### Technical Compliance Ratings

(C - compliant, LC – largely compliant, PC – partially compliant, NC – non compliant)

<b>R.1</b> - assessing risk & applying risk-based approach	<b>R.2</b> - national cooperation and coordination	<b>R.3</b> - money laundering offence	<b>R.4</b> - confiscation & provisional measures	<b>R.5</b> - terrorist financing offence	<b>R.6</b> - targeted financial sanctions – terrorism & terrorist financing
<b>PC</b>	<b>C</b>	<b>LC</b>	<b>LC</b>	<b>C</b>	<b>LC</b>
<b>R.7</b> - targeted financial sanctions - proliferation	<b>R.8</b> - non-profit organisations	<b>R.9</b> – financial institution secrecy laws	<b>R.10</b> – Customer due diligence	<b>R.11</b> – Record keeping	<b>R.12</b> – Politically exposed persons
<b>LC</b>	<b>LC</b>	<b>C</b>	<b>PC</b>	<b>LC</b>	<b>PC</b>
<b>R.13</b> – Correspondent banking	<b>R.14</b> – Money or value transfer services	<b>R.15</b> –New technologies	<b>R.16</b> –Wire transfers	<b>R.17</b> – Reliance on third parties	<b>R.18</b> – Internal controls and foreign branches and subsidiaries
<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>PC</b>	<b>LC</b>	<b>LC</b>
<b>R.19</b> – Higher-risk countries	<b>R.20</b> – Reporting of suspicious transactions	<b>R.21</b> – Tipping-off and confidentiality	<b>R.22</b> - DNFBPs: Customer due diligence	<b>R.23</b> – DNFBPs: Other measures	<b>R.24</b> – Transparency & BO of legal persons
<b>LC</b>	<b>PC</b>	<b>C</b>	<b>NC</b>	<b>NC</b>	<b>NC</b>
<b>R.25</b> - Transparency & BO of legal arrangements	<b>R.26</b> – Regulation and supervision of financial institutions	<b>R.27</b> - Powers of supervision	<b>R.28</b> - Regulation and supervision of DNFBPs	<b>R.29</b> – Financial intelligence units	<b>R.30</b> – Responsibilities of law enforcement and investigative authorities
<b>PC</b>	<b>LC</b>	<b>C</b>	<b>NC</b>	<b>C</b>	<b>C</b>
<b>R.31</b> – Powers of law enforcement and investigative authorities	<b>R.32</b> – Cash couriers	<b>R.33</b> – Statistics	<b>R.34</b> – Guidance and feedback	<b>R.35</b> – Sanctions	<b>R.36</b> – International instruments
<b>LC</b>	<b>C</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>
<b>R.37</b> – Mutual legal assistance	<b>R.38</b> – Mutual legal assistance: freezing and confiscation	<b>R.39</b> – Extradition	<b>R.40</b> – Other forms of international cooperation		
<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>C</b>		

Source: FATF (2016), Anti-money laundering and counter-terrorist financing measures - United States, Fourth Round Mutual Evaluation Report, FATF, Paris, [www.fatf-gafi.org/publications/mutualevaluations/documents/mer-united-states-2016.html](http://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-united-states-2016.html)