

## Original Paper

# Effectiveness of the UK AML System and Strategies for Improvement

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### Abstract

*As the cost of anti-money laundering (AML) compliance in the UK continues to rise, financial crime rates have not fallen. This study assesses the effectiveness of the UK's anti-money laundering (AML) system and proposes strategies for improvement. The research examines the current legal framework, including the Proceeds of Crime Act (POCA) and the Money Laundering Regulations 2017 (MLR2017), assessing their role in preventing and combating financial crime. Analyzing case studies and statistical data, the findings suggest that while the UK AML system has been effective in identifying and deterring money laundering, significant challenges remain. Insufficient sharing of information between agencies, uneven allocation of resources, and inconsistent regulatory enforcement hinder overall effectiveness. To address these shortcomings, the study makes several strategic recommendations: strengthening inter-agency cooperation, leveraging advanced technological solutions for data analysis and reporting, improving training and awareness programmes for financial institutions, and improving the legal framework to adapt to emerging threats. Implementing these recommendations could strengthen the UK's anti-money laundering (AML) efforts, making them more robust and responsive to the evolving financial crime landscape. Ultimately, this study aims to contribute to the current debate on the effectiveness of AML and to make recommendations for improving the AML system's response to the complexities of money laundering in order to strengthen the UK's position in the global fight against money laundering.*

### 1. Introduction

The financial burden of anti-money laundering (AML) compliance in the UK has been steadily increasing for over a decade. Instead of decreasing, financial crime rates have continued to rise despite significant investment. This situation prompts a critical investigation into the effectiveness of current AML measures at an operational level. A review of whether the existing AML framework is

fundamentally flawed and no longer able to effectively address the challenges it was designed to address is therefore necessary. Such a reassessment could provide a path for identifying the necessary reforms or alternatives to improve the effectiveness of anti-money-laundering efforts in the fight against financial crime.

Money laundering is itself a crime (Note 1). Money laundering is an illegal activity carried out by criminals which occurs outside of the normal range of economic and financial statistics (Note 2). According to the definition of International Compliance Association (ICA), money laundering is the generic term used to describe the process by which criminals disguise the original ownership and control of the proceeds of criminal conduct by making such proceeds appear to have derived from a legitimate source (Note 3). However, with the rapid advancement of modern technology, this illegitimate money can be transferred to any part of the world through electronic transfers. It's extremely harmful to the financial system, not only leading to market distortions that prevent normal economic activities from taking place in a fair market environment, but also creating additional compliance costs and reputation risks for financial institutions.

The cost of anti-money laundering compliance in the UK has been rising disproportionately for more than a decade, but financial crime rates have continued to rise. According to data released by the HM government, the number of people sentenced for money laundering offences is on a slow upward trend from 2018 to 2022 (data as of 2022) (Note 4). A serious concern arises in the current situation, which is the present AML system broken and no longer fit for purpose? As Whitehouse concludes that 'The cost of compliance is increasing rapidly but it would be a brave person who steps up to say that it is too high a price to pay for countering terrorism and serious crime' (Note 5). Indeed, the AML system has a number of problems and challenges, but it has not been broken and still carries out a key role in deterring and detecting money laundering.

This essay will initially consider the challenges for the AML system, secondly it will critically assess the effectiveness of the AML system in combating financial crime and property recovery and finally make some recommendations on the current system.

## **2. Challenges to AML Compliance**

The cornerstone of the United Kingdom's anti-money laundering legislation is the Proceeds of Crime Act (POCA), complemented by foundational regulations such as the Money Laundering Regulations 2017 (MLR2017). The Financial Conduct Authority (FCA) enforces these provisions in strict accordance with the established legal framework. The regulatory environment has been further strengthened with the introduction of Unexplained Wealth Orders (UWOs) under the Criminal Finances Act 2017 (CFA 2017). Unexplained Wealth Orders (UWOs) have proved to be an important tool in the investigation of individuals whose assets are disproportionate to their known legitimate income, and are particularly important in cases involving international corruption and money laundering. In addition, the Economic Crime (Transparency and Enforcement) Act 2022 reinforces

AML as a framework by increasing transparency requirements for foreign companies investing in UK real estate, thereby strengthening the government's ability to monitor money laundering and facilitate asset recovery. This includes mandatory registration and disclosure of beneficial ownership information, which enables authorities to more effectively trace the source of funds used in real estate transactions. Enhanced access to data allows for improved risk assessment, improves investigative capacity and ultimately helps to identify and recover illicit assets. While the Money Laundering Reporting Officer (MLRO) plays a crucial role in monitoring compliance within financial institutions—such as banks, insurance companies, investment firms, casinos, and high-value dealers—responsibility for oversight is not limited to the MLRO alone. Other designated professionals, such as Money Laundering Compliance Officers (MLCOs), also contribute to ensuring adherence to anti-money laundering regulations. These professionals play an important role in complying with anti-money laundering regulations, employing advanced technology for continuous monitoring, and ensuring that all employees are trained in the latest anti-money laundering practices to combat evolving criminal tactics. In addition, they are responsible for the critical task of generating and filing Suspicious Activity Reports (SARs) with the National Crime Agency (NCA) whenever signs of potential money laundering are detected. Despite the fact that the UK's anti-money laundering system is fairly well developed, it still suffers from a certain range of challenges.

### *2.1 Excessive Consumption of Labour Costs*

With the digitalization of finance, the internationalization of the modern financial system requires the implementation of anti-money laundering (AML) compliance measures globally, which increases the workload of Customer Due Diligence (CDD). The requirement for CDD to carry out detailed background checks on new versus existing customers requires financial institutions to have a certain level of competence in terms of financial and human resources. To comply with CDD regulations effectively, financial institutions must invest in robust systems and processes that enable comprehensive customer assessments. This includes implementing advanced technology solutions for data analytics, transaction monitoring, and risk profiling, which require significant financial resources. Furthermore, institutions need to ensure they have adequately trained staff capable of interpreting complex regulatory requirements and analyzing customer data accurately.

In addition, human resources are critical in establishing a culture of compliance within the organization. This involves not only hiring specialized personnel, such as compliance officers and risk analysts, but also providing ongoing training and professional development to enhance the skills of existing employees. Such training programs should focus on the latest trends in financial crime, evolving regulatory expectations, and best practices for conducting due diligence.

Moreover, the CDD process demands that financial institutions maintain detailed records of customer information and transaction histories. This necessitates a well-organized infrastructure for data management, ensuring that staff can efficiently access and analyze relevant information. Even many organizations have had to expand their compliance departments to cope with the workload created by

more comprehensive AML obligations. But this constant training is also a recurring cost for organizations.

The National Crime Agency (NCA) estimates the cost of money laundering to the UK economy to be in the hundreds of billion pounds a year (Note 6). In the True Cost of Compliance 2023 report published by LexisNexis, it was revealed that Customer due diligence (CDD) processes remain by far the largest single operational cost, representing two-thirds (67 per cent) of total financial crime compliance costs in 2022, an increase from 53 per cent in 2020 (Note 7). The largest share of CDD spend is represented by Know Your Customer (KYC) onboarding checks, accounting for just a third of overall CDD costs. Identity verification costs are also rising rapidly, partly as a result of increasing customer volumes and more consumers demanding a fast, seamless onboarding experience, and partly as firms work to improve their digital and remote onboarding solutions. The report indicates that 60 per cent of AML costs are spent primarily on personnel and training, with only 30 per cent invested in technology. And compliance costs will continue to increase over the next three years, with staffing costs growing slightly faster than technology costs. However, observing the matter through the economics lens again, these compliance costs have to be somehow recovered (Note 8).

Therefore, it is not difficult to conclude that these costs will be ultimately passed to end user, the customer. For example, the transaction fees charged by banks to asset managers and the costs of analysts' research reports are ultimately passed on to the clients of asset managers. Hence, higher costs may discourage customers from taking full advantage of banking services, thereby reducing the overall liquidity of the financial system. And in order to avoid the higher costs associated with formal financial channels, individuals and businesses may choose to underreport or not disclose their income or transactions, leading to increased shadow economy activity. It can further contribute to an increase in the rate of financial crime.

## *2.2 The Increasing Levels of Crime*

While the cost of AML compliance in the UK has continued to rise in recent years and into the future, yet the level of financial crime has not fallen. According to an assessment by the UK's National Crime Agency (NCA), the UK is likely to generate more than £10 billion in criminal cash each year (Note 9). Traditional fraud, while still prevalent, is generally on the decline (Note 10). However, as digitization and networking deepen, there has been a marked increase in forms of crime such as cryptocurrency-related crime, cyber fraud and identity theft. For example, the anonymity and cross-border nature of cryptocurrencies makes them a new tool for money laundering. In statistics released by the UK government in 2023, it was revealed that the UK's Financial Intelligence Unit (FIU) received 901,255 Suspicious Activity Reports (SARs) between 2021 and 2022, which represents a 21 per cent year-on-year increase compared to previous years (Note 11). One of the reasons for the increase is the growing fintech and cryptocurrency sector, which has led to the emergence of new types of criminal practices.

In the UK, for example, some bank account holders have become money laundering ‘mules’ through the misuse of digital technology and social media. According to records from 2017, 8,500 money mule accounts owned by young people were identified by a number of UK banks and there has been a 35 per cent increase in the involvement of the 14-21 age group in this type of money laundering (Note 12). This is because young people often have no criminal history of financial crime, so they are more likely to be trusted by banks unless other suspicious transactions are analyzed. Furthermore, according to the data released by Cipher Trace in 2019, 65% of the 120 most popular cryptocurrency transactions have poor and weak KYC requirements (Note 13). Despite the enforcement of strict customer due diligence (KYC) in the UK and compliance with the Fifth Anti-Money Laundering Directive, which strictly regulates cryptocurrency activity, and the proposed rules for cryptocurrency regulation by the FCA, technology continues to evolve, and cryptocurrency money laundering methods are becoming more complex and undetectable.

Thus, despite the significant increase in AML compliance costs, the persistence of high crime rates reflects the fact that existing measures may not be fully effective in practice.

### **3. Assess the Effectiveness of AML System**

An initial question that should be considered before analyzing the effectiveness of AML systems is what is effective? Effective means that the outcome is expected to fulfil the original purpose (Note 14). So what is the purpose of anti-money laundering? The objective of anti-money laundering is clearly to reduce money laundering and the incidence of money laundering offences. It is also to combat the flow of funds for the financing of terrorism and to protect the integrity of financial markets. However, as noted earlier, the cost of anti-money laundering compliance continues to rise, but the rate of financial crime has not fallen. As a result, it has been argued that the anti-money-laundering system has been undermined. In the perspective of this essay, however, the AML system has not been broken. How should damage be defined? Is it the elimination of all financial crimes that can be said not to have been damaged? Obviously this is impossible. The purpose of anti-money laundering is to combat money laundering, but the money laundering to 0 crime can not exist. Although the AML system has not prevented an increase in the rate of financial crime, which it has to a certain extent, it has also combated financial crime, and therefore has not been broken.

For instance, the UK introduced Unexplained Wealth Order (UWO)—a regime designed to forfeit the proceeds of crime using civil, rather than criminal power from 2017. The UWOs are seen as a solution to both the problems of organized crime and the high levels of corruption that arise from a reign of thievery. When a property is issued with an Unexplained Wealth Order (UWO), the owners are obligated to provide an explanation regarding the origins of wealth used for its purchase. Failure to comply with this requirement establishes a legal presumption that the property has been obtained through criminal proceeds, thereby enabling subsequent civil recovery proceedings for confiscation under the provisions of the Proceeds of Crime Act (POCA) (Note 15).

In 2019 the NCA froze 3 properties as it suspected that they were the proceeds of crime transferred to the three properties by Rakhat Aliyev (RA), a Kazakhstani national, and asked the respondents to explain the source of the wealth. However the High Court overturned all three UWOs, finding the assumptions expressed by the NCA that RA was the source of the funds to be unreliable and finding the underlying assumptions and reasoning of the NCA to be unreliable and flawed (Note 16). 2020 The NCA appeal was refused. This case is one of four known UWO cases to have failed completely. In particular, when applying for the UWO, NCA claimed that some of Hajiyeveva's assets were of dubious origin, and therefore asked her to explain how she could afford them. However, the key issues in the case centred on whether NCA had used the UWO tool correctly and whether its judgement on Hajiyeveva's property complied with the law. The court found the NCA procedurally improper in some respects, particularly in relation to the question of beneficial ownership of the property and the associated legality, for which it did not provide sufficient evidence. This was largely due to disputes over the legality of the source of the RA property, the complexity of ownership of RA assets, and issues of procedural justice. NCA had failed to adequately prove a reasonable suspicion of illegality with respect to certain of Hajiyeveva's assets in the case. Hajiyeveva's team of lawyers successfully challenged NCA's assertion that the property had not been acquired by illegal means, and that the UWO should therefore not have been applied. The court was sceptical of NCA's chain of evidence and reasoning, finding them insufficient to support the decision to freeze the property.

Another key factor was the complex ownership structure involved in some of the property owned by Hajiyeveva. Some of the assets were not owned by her directly, but through trusts or corporate holdings. This made it difficult for the court to determine whether the property should be attributed to Hajiyeveva, finding that NCA had failed to accurately identify who the true owner of the assets was. The court also challenged NCA's procedures in applying for the UWO, finding that some of the procedural deficiencies may have violated Hajiyeveva's legitimate legal rights. For example, in some instances, NCA may have failed to give Hajiyeveva an adequate opportunity to respond to the allegations or may have failed to follow certain required legal procedures, resulting in the decision to freeze some of the assets being deemed unlawful. The use of the UWO in the RA case thus reveals the potential of the tool for tracing unexplained wealth, but also exposes its limitations at the legal and procedural levels. While the UWO offers the UK government a new way to effectively combat money laundering and corruption, its successful implementation depends on the specific complexity of the case, the structure of the asset holdings, and the ability of law enforcement agencies to adhere strictly to legal procedures. The RA case demonstrates that, while the UWO is a potent tool, there are a number of legal and practical hurdles that still need to be overcome in practice.

It has been argued that UWO has failed as a specific tool in the AML regime (Note 17). However in the Asset Recovery Statistical Bulletin published by the UK Government 2023 (for the financial year ending March 2018 to March 2023), it is shown that in the financial year 2022-2023, £62.9 million was recovered under civil recovery orders, a growth rate of 544 per cent from £9.8 million in the previous

financial year (Note 18). Thus, rather than looking at a handful of failures and judging the ineffectiveness of AML tools, we can start with the data to see if the AML system is actually fulfilling the original purpose of anti-money laundering. Which means that if the anti-money laundering system combats money laundering and achieves certain results, then it is effective.

#### **4. How to Improve AML System?**

##### *4.1 Focus on Regtech*

As mentioned previously, AML compliance costs account for only 30% of technology investment, with the majority of costs spent on labour and compliance training costs, demonstrating the problem of under-investment in technology. Consequently, the UK should invest more in regtech, using artificial intelligence and big data analytics to automate the process of detecting and reporting suspicious transactions. Regtech is an abbreviation for regulation and technology, meaning it is a reliance on technology for regulatory and compliance purposes (Note 19). Regtech can better detect criminals by automating the identification of suspicious transactions. Meanwhile regtech will also simplify the KYC and CDD process as it provides tools that are aligned with the digital transformation of the financial services industry. And regtech will enable regulators to respond adequately to emerging financial risks by providing more accurate and timely data reporting. Between 2013 and 2019, Westpac, the second largest bank in Australia, was accused of 23 million breaches of the worst money laundering and terrorist financing laws in the country's history (Note 20). According to the investigation, most of the breaches were linked to the bank's failure to report international transfers in a timely manner to the Australian Transaction Reporting and Analysis Centre (AUSTRAC), which claimed that 12 individuals used the system of Westpac to conduct nearly 3,000 transactions that may have been related to child exploitation, as well as child sex shows. Moreover, the group included a customer who had been previously convicted of child exploitation offences. Yet Westpac did not implement an automated detection programme, but instead monitored risks through other channels. As a result, Westpac failed to detect transactions on its customer's account related to child exploitation. This case illustrates the potential for the use of regtech, in other words, the increased use of regtech will reduce the risk of human error to a certain extent.

In the UK, the FCA has set up regulatory sandboxes with the aim of providing a safe testing environment for new financial services and technologies that do not pose a potential risk to the financial system as a whole or to the consumer community until they are fully compliant with regulatory requirements (Note 21). The Regulatory Sandbox provides an experimental platform for regtech, allowing firms to test and optimise technologies, such as trade regulation tools, compliance management systems, etc., in real market environments, which promotes innovation in regtech. Whilst the UK regtech environment is sufficiently robust, it still has a few issues that need to be improved. For example, data privacy and security issues. the UK has been strictly observing the General Data Protection Regulation (GDPR), which has largely increased the security and transparency of personal

data processing. However, in regtech applications, it is often necessary to co-operate with third parties, which involves data sharing. As a result, when mishandling or inconsistency in compliance with co-operating parties occurs, these personal data will face privacy and security issues. Hence, the UK should focus more on the regtech aspect, which needs to be addressed through more comprehensive policies, more optimal management and continuous regulatory innovation.

#### *4.2 Enhanced International Cooperation*

The FCA established the Global Financial Innovation Network (GFIN) in early 2018 on top of a proposal to create a global sandbox, and officially launched it in January 2019 (Note 22). The GFIN serves as a platform for international regulatory and financial innovation collaboration, and aims to provide innovative firms with a more effective way of interacting with regulators and to help them navigate between different countries as they seek to promote new ideas. GFIN enhances the joint regulation of AMLs globally by creating a collaborative network of multinational regulators for information sharing. In October 2020 GFIN published the first official Cross-Border Testing Lessons Learned (CBT). The report shows that participating companies must demonstrate that the product or service they are involved in testing meets the eligibility criteria of each regulator in the jurisdiction (Note 23). However, due to the widely varying eligibility criteria of participating regulators, it poses a significant challenge for many companies, which leads to difficulties in collaborating and aligning. In addition, as the Internet continues to evolve, the means of laundering digital currencies across borders has become more insidious. The UK should give more professional resources and support to develop a unified framework and policy to promote uniform international regulatory standards. And track transnational money laundering activities by strengthening compliance information sharing and coordination between countries.

### **5. Conclusion**

The original purpose of the AML system was to combat financial crime. Whilst the cost of AML compliance in the UK continues to rise at the same time as the level of financial crime is rising, it does not indicate that the AML system is ineffective. According to some data and reports, the AML system is effective in combating financial crime and achieving the original purpose of the system. Which means that the system is not broken, it just has some issues that need to be improved.

Firstly AML's compliance costs are disproportionately high in terms of staff and compliance training costs, and smaller in terms of technology. It means less investment in innovative regulation and less automation of regulation. The second is that as technology continues to progress, so does the level of crime. The money laundering methods of criminals have also become more sophisticated and difficult to track. In addition, the effectiveness of the AML system is demonstrated through data released by the government as well as case studies. It also explains why the AML system cannot be judged to be ineffective just because the level of crime has increased.



This essay also makes some recommendations for the improvement of the AML system so that it can better address the increasingly complex problem of money laundering regulation.

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