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DEBANKED

The economic and social consequences of anti-money laundering regulation

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Summary

- Debanking became a news story in 2023 when Nigel Farage alleged that Coutts had closed his account because its executives disapproved of his political opinions.
- A study by the Financial Conduct Authority (FCA) revealed that such ideologically motivated account closures are vanishingly rare.
- Nevertheless, debanking is a problem in the UK. In 2021/22, UK banks closed 343,000 accounts. In about half of those cases, the reason was that the bank could not satisfy itself that the customer was not involved in money laundering or other financial crimes.
- The penalties for failing to comply with the government's anti-money laundering (AML) regulations can run into hundreds of millions or even billions of pounds. Certain kinds of customers present a relatively high *prima facie* risk of being involved in money laundering. But the cost of discovering whether they really are criminals would exceed the value of their business. So, banks close their accounts – even though most of those people are innocent.
- Other customers are also harmed. Complying with AML regulations costs UK banks £34 billion a year, twice what is spent on policing all other crimes put together. This cost is ultimately borne by bank customers.
- There is no evidence that AML regulations reduce crime, and the governments that impose them have not even tried to show that they do. With no evidence of benefits and the costs known to be massive, the AML regulations should be scaled back, for example by going back to the pre-2017 regulatory regime, if not further.
- That is unlikely to happen given politicians' enthusiasm for regulation and reluctance to admit error. In that case they should compensate banks for the compliance cost. This would remove the injustice of forcing bank customers to bear the cost of fighting crime. And it would make the extraordinary cost of AML regulations politically visible.

Introduction

The issue of ‘debanking’ hit the news in July 2023 when Nigel Farage, *GB News* presenter and former leader of the UK Independence Party (UKIP), announced that Coutts, the private banking division of NatWest bank, had closed his accounts because they disapproved of his political views. The ensuing scandal resulted in the resignations of Peter Flavel, the CEO of Coutts, and Alison Rose, the CEO of NatWest.

The Financial Conduct Authority (FCA) launched an inquiry to find out how often banks were closing customers’ accounts, and for what reasons. It discovered that in 2021/22, the most recent financial year for which data is available, not a single account was closed because of customers’ political views. Shortcomings in the FCA inquiry mean that some doubt remains. But the gist is correct. The chance of having your bank account closed because of your political opinions is vanishingly small.

Nevertheless, debanking is a problem in the UK. In 2021/22, UK banks closed 343,000 accounts, up from 45,000 in 2017 when the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017* (MLR 2017) was passed into law[1]. The reason in about half the cases was the bank’s inability to satisfy itself, to the standards set in response to the MLR 2017, that the customer was not involved in money laundering or terrorist financing (FCA 2023: Section 4). This is a commercially rational response given that the fines for being deemed non-compliant can be in the billions, and that responsible staff can face serious personal penalties.

1 ‘UK banks are closing more than 1,000 accounts every day’, *The Guardian*, 30 July 2023 (https://www.theguardian.com/business/2023/jul/30/uk-banks-closing-more-than-1000-accounts-every-day).

Customers whose accounts are not closed also pay a material price, because complying with the government's anti-money laundering (AML) regulations costs UK banks £34 billion a year, which is double the £17 billion spent on policing all other crimes in the UK (Lexis Nexis 2023). This cost must ultimately be passed on to customers through higher account fees, higher rates of interest on loans, and/or lower interest rates on deposits.

Like other businesses, banks are rightly free to deny their services to anyone they choose, constrained only by anti-discrimination law. Freedom of association should not be restricted to amateurs. But this freedom has a perverse effect when banks are co-opted by the government to act as crime fighters.

Imagine that having your bank account closed were made a criminal penalty. A court could not impose it on anyone without evidence that proved, beyond reasonable doubt, that he had committed the alleged crime. But a bank is not a court, and it is making a business decision rather than imposing a legal penalty. It closes accounts when gathering evidence costs too much, not when the evidence gathered proves the customer to be a criminal. Banks thus impose the 'penalty' of account closure on the basis of evidence that would not suffice in a court. Many tens of thousands of innocent people are punished every year.

The government responded to the Farage debanking scandal in predictable fashion by adding to the already astonishing quantity of banking regulations. It did not create a legal right to a bank account, as exists in Belgium and France. Rather, it required banks to explain the decision and to give customers 90 days' notice, up from 60 days. It failed to see that, as so often, the problem arises from its prior regulatory impositions.

Given the lack of evidence that banks' post-2017 AML obligations have done anything to reduce crime compared with pre-2017 trends, you might hope that the UK government, and all others, would simply eliminate them. As anyone familiar with contemporary politics will know, however, this is a vain hope.

A solution that just might have a chance of being adopted is to transfer the cost of AML due diligence from banks to the government: that is, to taxpayers. Not only would this stop the due diligence from making many customers unprofitable for banks, but it would avoid the injustice of the current regime, whereby the cost of fighting money laundering is arbitrarily imposed on banks and their customers. And it would make the astonishing cost of AML regulations politically visible and politically painful.

Risk-adjusted profits and the cost of information

To understand why banks have responded to AML regulations with mass debanking, we must first understand the profitability of a bank account. The revenues from a bank account come from fees and interest margin. Interest margin is the difference between the internal transfer price of the funds and what the bank receives from the customer (in the case of a loan) or pays to the customer (in the case of a deposit).

The internal transfer price is a mechanism for allocating revenues between the deposit-gathering and loan-granting divisions or functions of the bank. Suppose the bank pays depositors 1% and charges borrowers 3%. If the internal transfer price is 2%, then a £100 deposit contributes £1 a year to revenue (=£100*(2%-1%)), and a £100 loan contributes £1 a year (=£100*(3%-2%)).

Consider a simple case. Susan Smith has a current account with Acme Bank. Acme charges Susan an annual account fee of £100 a year. The average daily balance of her account over the course of the year is £1,000. The bank pays no interest on her account, and the internal transfer price for these funds is 2%. Then Acme makes £20 in interest margin. So, the total annual revenue from Susan's account is £120.

It is difficult to say what an individual account costs a bank, because much of what services the account – the online banking system, head-office treasury functions and so on – are fixed costs, and allocating fixed costs to individual customers is notoriously difficult. But let's suppose Acme has used the finest management consultants known to humanity and worked out that serving Susan costs it £20 a year.

It may seem that Acme profits £100 from providing Susan with her current account: that is, £120 in revenue less £20 in costs. But this is too quick, because we have left out the risk of serving Susan.

A bank's customers present it with risk. Most commonly, this arises when customers borrow. The bank then faces the risk that the customer will fail to make the interest payments or repay the loan. But such credit risk is not the only risk in banking. For example, banks can also lose money through fraud, systems failures or natural disasters (event risk), from the devaluation of securities or currencies they hold (market risk), from demand for their services unexpectedly falling (business risk), or from fines or lawsuits (legal risk). But, to understand the profitability of an account or customer, the source of the risk does not matter. What matters is its size.

Suppose that by providing Susan Smith with her current account, Acme incurs a risk R_{SS}. The cost of this risk to Acme is what it would cost to insure the risk: that is, the premium it would need to pay an insurer to cover the loss that might arise from the risk. If Acme does not insure the risk with a third party, if it instead carries the risk and 'self-insures' by setting aside capital sufficient to cover the risk, it still incurs a cost (the opportunity cost of the capital) which is roughly equivalent to the premium that an insurer would charge. Suppose the premium for R_{SS} is £150 a year. Now Susan has gone from being a profitable customer to an unprofitable one. She now loses Acme £50 a year (=£120 revenue *less* £20 operating cost *less* £150 risk cost).

One more complication. Customers differ in how much risk, of any particular kind, they present the bank (as a percentage of their account balances). Though risk is usually continuous, to simplify, suppose that the kind of risk Susan presents comes in three sizes, with three corresponding insurance premiums (given her average balance is £1,000): low risk = 5% (£50), average risk = 15% (£150), and high risk = (30%) £300. If Acme could tell that Susan was not average risk but low risk, the cost of insuring her would fall from £150 to £50. And then her account would profit Acme £50 a year (=£120 revenue *less* £20 operating cost *less* £50 risk cost).

Susan's account will not necessarily survive, even if she is, in fact, a low-risk customer, and profitable for Acme. For the information required to determine her true risk does not come free. Suppose the cost of gathering and evaluating that information is £100 a year. Then it is not worth finding out whether Susan is not in fact average risk but low risk. The cost of finding it out is greater than the profit from serving her, even if it is discovered that she really is low risk. And, of course, this might not be discovered, which makes spending the £100 on trying to find out an even worse idea.

This is the economic logic of account closures and declined applications. It has two implications that explain the surge in debanking. Anything that increases the risk presented by an account or the cost of distinguishing relatively risky customers from relatively safe ones will increase the number of customers that it is unprofitable to serve. And smaller accounts, which deliver less revenue, will always be more likely to be unprofitable than large accounts.

The debanked

As the FCA’s recent report on bank account closures shows, the reason for most account closures is either suspicion of financial crime (money laundering, financing terrorism or tax evasion) or an inability to perform the due diligence required to assure themselves that the customer is not involved in financial crime. Serving customers with an apparently high probability of being involved in financial crime presents a risk of losses to the bank and, following the logic described above, explains why they close so many accounts.

Return to Susan Smith and her account with Acme. Suppose Susan is a prostitute working from her home and advertising her services online. (Prostitution is legal in the UK. What is illegal is procuration, running a brothel, and soliciting in a public place.) She makes sporadic large cash deposits into her account. This is a flag of financial crime. Large cash deposits could, for example, be the earnings of a drug dealer or someone trying to evade taxation. Acme could try to find out whether Susan really is a drug dealer or tax evader. But doing so would be expensive, and still leave some uncertainty. And Susan’s account produces little profit in any event. Closing the account is the sensible option.

The same logic explains the types of banking customers who are especially prone to debanking. Certain customers present a higher *prima facie* probability of being involved in financial crime. Most are not, of course. But the cost of finding out which really are exceeds the value of their business. So, except for those few who provide revenues large enough to be worth the cost of finding out, whole swathes are debanked.
Here is a list of customer categories who are especially likely to be debanked, and the reason they present a high *prima facie* risk:

- *Sex workers*: cash deposits suggesting drug dealing or tax evasion
- *Racecourse bookies*: cash deposits suggesting drug dealing or tax evasion
- *Charities*: donations from corrupt foreigners or money launderers, activities in corrupt countries, funding terrorism
- *Cryptocurrency businesses*: cryptocurrencies, like cash, are anonymous. Cryptocurrency deposits are suspicious in the same way that large cash deposits are suspicious
- *Small companies with business in developing economies*: unknown sources of funds which may well be criminal
- *Expats*: Unknown sources of funds, which may well be criminal
- *Politically Exposed Persons* (PEPs): funds sourced from bribes or 'kickbacks', theft from public funds, proceeds of sanctions violations.

The managers of a bank need make no moral judgement on these categories of customer to reject their business. They simply present *prima facie* risk of being involved in financial crime, and it is not worth spending what it would cost to find out which of them are innocent.

Barclays Bank cannot morally disapprove of expats: that is, of British citizens living overseas. Nor can it believe that all or even most of them are financial criminals. Nevertheless, in October 2023, it closed all their accounts[2]. That is to say, it withdrew from the business of serving expats. Though Barclays did not publicise its reason, the policy is an unsurprising response to the extra costs that AML regulations place on banks serving overseas customers. Nigel Green, CEO of DeVere Group (a wealth management advisory), responded to the news by saying: 'We have been warning expats since November 2020 that many Britons who live overseas face being stripped of their UK bank accounts and credit cards because of increasing required, expensive and onerous compliance measures they need to take[3].'

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2 'Signal: Barclays to close thousands of expats' accounts', *Retail Banker International*, 2 October 2023 (https://www.retailbankerinternational.com/news/barclays-to-close-thousands-of-expats-accounts/?cf-view).

3 'UK high street banks abandoning expats – and it's going to get worse', *Business Money*, 27 September 2023 (https://www.business-money.com/announcements/uk-high-street-banks-abandoning-expats-and-its-going-to-get-worse/).

The source of the risk

The basic function of banks is to intermediate borrowers and lenders, who would otherwise find it difficult to find counterparties with matching preferences regarding the size and term of the loan. This is an inherently risky business. Those to whom a bank lends may fail to make the interest payments or repay the principal. And the ‘maturity transformation’ performed by banks – typically using the funds from short-term deposits to make long-term loans – exposes banks to the risk that interest rates will change in a way that makes their assets (loans granted) depreciate and their liabilities (deposits accepted) appreciate. Managing these risks, and others that arise in the normal course of doing business, is a fundamental competency of bank management.

Like other governments, the UK government regulates banks’ risk-taking, primarily by telling banks how much capital they must hold as a buffer against losses they might incur through their normal business activities. The justification for this intervention in what would normally be a purely commercial matter is that bank failures are not just private problems for those who choose to invest in them or work for them, but problems for society more broadly. Bank failures can have ‘contagion’ effects which result in an economic crisis. That is why governments often bail out failing banks. This (implicit) government guarantee acts as a subsidy for banks’ risk-taking, which is thus inclined to be excessive. Government-imposed risk regulations are required to counteract the perverse incentive created by the implicit guarantee. That, at least, is the idea (Haldane 2010).

The risk that banks face regarding money laundering is different. Money laundering would not, in itself, present banks with risks, were it not for the fact that governments fine banks that fail to prevent it. Susan’s brother, Sam Smith, is a drug dealer. He takes payment in cash and deposits the money at the Camden branch of Acme Bank. Where is the risk for Acme?

Cash deposited by criminals is, from the bank's perspective, indistinguishable from deposits made by the law-abiding.

The only candidate for a genuine commercial risk from accepting deposits from criminals, a risk not created by the government, is 'reputational risk'. Over the last two decades there has been much talk of reputational risk in banking, and in 2013 the FCA issued guidance encouraging banks to create reputational risk committees (RRCs). AML measures are sometimes explicitly justified as part of managing reputational risk[4].

The idea must be something like this. If a bank accepts deposits from criminals, this fact may become known, and people would then take a dim view of the rigour or ethics of the bank's management. This disapproval will cause non-criminal customers to withdraw their business, and the bank will make losses – large enough, perhaps, to threaten its solvency.

This is implausible, if only because no such response by law-abiding bank customers can be observed. Back in the old days of banking secrecy in Switzerland, banks there frequently accepted the proceeds of crime and political corruption. And the customers of those banks must have known it. But the prestige and profits of Swiss banks did not suffer on account of this. Nor have UK banks suffered from their involvement in scandals. As a report by the All-Party Parliamentary Group on Fair Banking (APPG 2024: 15) put it:

> Major high street banks have been involved in the fraudulent manipulation of interest rates, terrorist financing and money laundering on behalf of major drug cartels with little or no noticeable impact on customer loyalty.

It is not banks' accepting criminal funds that harms law-abiding customers, but their efforts to avoid it. The cost of the due diligence that banks perform to ensure customers are not criminal, typically called Know Your Customer (KYC), must ultimately fall on bank customers. Even customers who do

4 See, for example, 'The fight against money laundering and terrorism financing', *International Monetary Fund*, 2023 (https://www.imf.org/en/About/Factsheets/Sheets/2023/Fight-against-money-laundering-and-terrorism-financing), 'The high cost of AML non-compliance', *Flagright*, 6 July 2023 (https://www.flagright.com/post/the-high-cost-of-aml-non-compliance) and 'Why money laundering is a risk for organizations', *Financial Crime Academy*, 4 March 2024 (https://financialcrimeacademy.org/why-money-laundering-is-a-risk-for-organizations/).

not have their accounts closed suffer higher prices to cover banks' costs: that is, higher rates of interest charged for loans, lower rates paid for deposits or higher account fees.

This additional cost is not trivial. A study by Lexis Nexis and Oxford Economics estimates banks' cost of complying with AML regulations to be £34.5 billion a year (Lexis Nexis 2023), double the £17.4 billion the government spends on policing all other crimes put together. This is an average cost of £220 a year to each of the UK banks' roughly 160 million customers, which includes not only British individuals but also some foreign individuals and both British and foreign companies[5]. On top of these monetary costs, customers must furnish the required evidence, which is difficult for many. And they must put up with delays in banks' decision-making.

Banks do face reputational risk. But it is their reputation regarding matters that threaten insolvency where risk arises. If a bank's depositors believe it to be approaching insolvency, they will try to get their money out all at once. In other words, there will be a run on the bank. And, since banks hold only a fraction of depositors' funds in liquid assets, they will default on their obligations. HSBC's reputation was damaged in July 2012 by the revelations that it had been laundering money for Mexican drug cartels. But it suffered no such run, because accepting these funds did not threaten its solvency. On the contrary, all else being equal, accepting these funds improved HSBC's solvency. Despite the scandal, the value of shares in HSBC increased by 30% in 2012, up from £498.20 at the beginning of the year to £651.30 at the end. The loss to HSBC came not from the money laundering itself, nor from the reaction of its law-abiding customers, but from the US federal government, which fined it $1.9 billion.

In short, banks' AML and KYC regimes are not a profit-maximising response to the reputational risk of being involved in money laundering or directing funds to terrorists. They are a profit-maximising response to the demands of regulators and the risks of suffering large fines for non-compliance.

5 Statista (2024) *Customers of leading UK banks 2022*. Accessed: 10 April 2024 (https://www.statista.com/statistics/940560/number-of-customers-at-select-banks-in-the-united-kingdom/).

A brief history of AML regulation

The current AML regulations – which apply not only to banks but also to law firms, casinos, art dealers and other businesses that might end up in receipt of large sums of illegally sourced money – have their origin in the Financial Action Task Force (FATF), established by the G7 in 1989 to combat money laundering.

In 1990, the FATF published its 40 Recommendations for how member countries should combat money laundering (FATF 2012b). These have been updated several times since and now include measures aimed at preventing terrorist financing, which was added to the FATF's remit in 2001. They include the recommendation that banks be obliged to perform customer due diligence (CDD) to assure themselves that they are not involved in money laundering. Four CDD measures are required:

(a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information

(b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner. For legal persons and arrangements this should include financial institutions understanding the ownership and control structure of the customer

(c) Understanding and, as appropriate, obtaining information on the purpose and intended nature of the business relationship

(d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of

> the customer, their business and risk profile, including, where necessary, the source of funds (FATF 2012a: 14).

If a bank cannot conduct the due diligence satisfactorily, it must close the customer's account/s, or refuse to open an account for a prospective customer. If the due diligence results in suspicion of money laundering, the bank must report the customer to its country's Financial Intelligence Unit.

Member governments, which include most Western countries and major banking centres (Hong Kong and Singapore), have implemented the 40 Recommendations through domestic law. In the UK, the process began with the *Money Laundering Regulations* (1993) and culminated in *The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017* (MLR 2017), which has since been amended twice. MLR 2017 is not primary legislation, debated in parliament, but a statutory instrument created by the Treasury, of which the FCA is a part. Similarly, AML regulations in other countries are created by the agencies that supervise banks. And these supervisory agencies are empowered to enforce the regulations by imposing fines on banks they deem to have failed to meet their AML obligations.

This power is not merely theoretical. Supervisory agencies have imposed many fines on banks for AML failings. And the fines can be massive. In the past ten years, six banks have paid fines in excess of $1 billion for AML non-compliance:

- 2014: BNP Paribas, $9 billion
- 2018: Société Générale, $1.4 billion
- 2018: ING, $1.8 billion
- 2019: UBS, $4.2 billion
- 2019: Standard Chartered, $1.1 billion
- 2023: Danske Bank, $2.2 billion

Many more banks have been fined tens or hundreds of millions of dollars.

No actual money laundering need be detected. Banks are fined because the supervisory agency forms the opinion that their AML procedures are not up to scratch. For example, in July 2015 Citigroup agreed to pay the California and federal banking regulator fines totalling $140 million for purported AML weakness in its Banamex USA subsidiary. It simultaneously announced that it would close Banamex USA, a small bank with only three branches (in Houston, San Antonio and Los Angeles) and total assets only six times the $140 million fine. The regulators had discovered no actual money laundering. Banamex's 'crime' was to devote too few staff to complying with AML regulations.

Similarly, the FCA fined Deutsche Bank £163 million in 2017 not because it had discovered money laundering, but because it deemed Deutsche Bank's AML controls to be inadequate. According to Mark Steward, Executive Director of Enforcement at the FCA, the bank had 'put itself at risk of being used to facilitate financial crime and exposed the UK to the risk of financial crime'[6].

6 'FCA fines Deutsche Bank £163 million for serious anti-money laundering controls failings', *Financial Conduct Authority*, 31 January 2017 (https://www.fca.org.uk/news/press-releases/fca-fines-deutsche-bank-163-million-anti-money-laundering-controls-failure).

Political debanking

The FATF's 40 Recommendations suggest that governments require banks to perform extended due diligence on politically exposed persons (PEPs). PEPs are people whose position in politics, construed very broadly, makes them unusually likely to be in receipt of illicit funds, such as bribes, money stolen from state enterprises or receipts from sanctions violations. On the FCA's definition, PEPs include not only government ministers and members of parliament but also senior civil servants and judges. They also include the close relatives and business associates of PEPs (FCA 2017).

Nigel Farage does not appear to qualify as a PEP. He is not a member of parliament, a judge or a senior civil servant. He is a television personality. Nevertheless, the 40-page document released by Coutts, which included internal correspondence concerning its decision to close his accounts, describes him as a PEP. Perhaps Coutts believed he qualified because he is a close associate of Russian PEPs. Some documents in the report referenced rumours that Farage was in receipt of Russian money. The documents also reference 'the extra cost attached to managing the accounts of high profile people such as NF'.

Farage's case may, therefore, conform to general logic of debanking described in this paper. Coutts may have figured that the AML-related risk he presented, combined with the cost of assuring themselves that he is not in fact a criminal, made him an irredeemably unprofitable customer. (I can only guess, because the 40-page report does not give the final reason for closing Farage's accounts, and bank executives made inconsistent public statements about the decision.)

A more likely explanation, however, is that Coutts executives were indulging their personal preferences. A Coutts briefing note states:

> The values NF actively and publicly promotes/champions do not align with the bank's. Particularly given the manner in which he states (and monetises) those views – deliberately using extreme, hateful and emotive language (often with a dose of misinformation) – at best he is seen as xenophobic and pandering to racists, and at worst, he is seen as xenophobic and racist. He is considered by many to be a disingenuous grifter.

The business rationale for closing the account of someone whose values 'do not align' with the bank's is avoiding damage to the bank's desired brand. If Coutts' desired brand is associated with values that differ from Farage's, then its managers may want to publicly dissociate the bank from him.

There was no evidence that having Farage as a customer was damaging Coutts' brand or losing them customers, which is why I suspect Coutts' management of indulging their personal preferences. But such self-indulgence by management is a principal-agent problem for the board and shareholders of Coutts to sort out, not a problem to be solved by the banking regulator. It calls for regulatory intervention no more than would the discovery that a bank's CEO directs its capital to sponsoring rugby, not because this genuinely benefits the bank but because he is a rugby lover.

Insofar as it was an example of values- or brand-based debanking, Farage's case does not fit the general pattern of debanking. It is not a response to the risks and costs created by the government's AML regulation. But other cases involving PEPs are. The APPG on Fair Business Banking (2024: 17) details the case of Sergey Grachev, a British citizen born in Russia whose various businesses' accounts were closed by Barclays following the Russian invasion of Ukraine. Mr Grachev is a reputable businessman, and Barclays had no evidence of criminal activity by him. But, as we have seen, given the potential costs, no such evidence is needed to make it commercially prudent to close the accounts of those who present a high *prima facie* risk.

How common are political account closures, of either the values-based variety or the PEP AML-risk variety? The number cannot be great given that few people are PEPs, and few people express political opinions misaligned with the ideological commitments of their bank in a way that would come to their bank's attention. The FCA's recent survey of UK financial firms regarding their reasons for closing accounts did not answer the question. The four cases where banks initially said they closed accounts because of the political views of customers turned out to be caused by threatening or abusive behaviour by the customer. However, banks said they closed many more accounts for reasons of reputational risk. And the FCA survey did not uncover the source of this reputational risk, which, for all we know, may have been the risk of association with certain political opinions.

The concern about political debanking, of the values-based variety, is that it might stifle political speech. It might extend ‘cancel culture’ into the financial sector. But, notwithstanding the shortcomings of the FCA survey results, the Farage case really does seem to be anomalous. Farage is but one of many public figures who express unfashionable opinions. Yet Farage’s debanking is an isolated case. Other public figures with similarly unfashionable opinions, such as Laurence Fox, Douglas Murray or David Starkey, have not had their bank accounts closed. And the CEOs of Coutts and NatWest ended up losing their jobs, while Farage still has a bank account. Debanking is not currently a threat to free speech.

Correspondent banking

The AML obligations of banks impose material costs on bank customers in countries that are members of the FATF, often resulting in the accounts of law-abiding citizens being closed. But the costs they impose on citizens of many poor countries that are not members of the FATF are even greater. The special requirements that AML regulations apply to 'correspondent banking' (payments made between banks in different countries) make international payments, including remittances, more expensive in various poor countries, and effectively impossible in some.

The FATF's Recommendation #7 states:

> Financial institutions should, in relation to cross-border correspondent banking and other similar relationships, in addition to performing normal due diligence measures:
>
> a) Gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision, including whether it has been subject to a money laundering or terrorist financing investigation or regulatory action
>
> b) Assess the respondent institution's anti-money laundering and terrorist financing controls
>
> c) Obtain approval from senior management before establishing new correspondent relationships
>
> d) Document the respective responsibilities of each institution
>
> e) With respect to 'payable-through accounts', be satisfied that the respondent bank has verified the identity of and performed

on-going due diligence on the customers having direct access to accounts of the correspondent and that it is able to provide relevant customer identification data upon request to the correspondent bank.

Banks have responded by severing correspondent banking relationships in countries where earnings are too small to warrant risks that would remain high even after performing the costly due diligence. The same logic that leads to debanking domestic individuals and businesses leads to debanking foreign banks and ‘money services businesses’: that is, non-bank payment services providers. The countries most affected are those where organised crime is prevalent, where political corruption is rife, and where economic under-development means the domestic banks are unlikely to pass conditions b) and e) above. According to an IMF report (2016: Part II), the countries most affected are smaller jurisdictions in Africa, the Caribbean, Central Asia and the Pacific.

The effect is not to make international payments impossible in these countries. There are still alternatives to the Western banks that have severed correspondent banking relationships. But they are more expensive and often (ironically) less transparent, because they work through a greater number of intermediaries. In this way, AML regulations drive up the cost and difficulty of making international payments to and from many poor countries, and of arranging trade finance facilities with counterparties in them (ibid). They make poor people yet worse off and impede economic development (ibid).

In zones destabilised by war, the consequences are yet worse. For example, there is not a single correspondent banking relationship with Somalia. No bank will transfer money there for fear of violating the rules against funding terrorism. Since more than 40% of Somalis depend on relatives working overseas to pay for food and medicine, this has caused immense suffering. The extreme hardship has caused an extreme response. Many Somalis living in the US now get money to their relatives by hiring agents to fly to Somalia with suitcases stuffed with cash[7].

7 Trindle, J. ‘Money keeps moving toward Somalia, sometimes in suitcases’, *Foreign Policy*, 15 May 2015 (https://foreignpolicy.com/2015/05/15/money-keeps-moving-toward-somalia-sometimes-in-suitcases/).

Banks as police and judges

As noted in Section 4, ‘The source of the risk’, banks have no strong commercial interest in avoiding the business of money launderers. AML regulations are not aimed at stabilising the banking system, since money laundering does not threaten the solvency of banks. Rather, AML regulations co-opt banks into crime fighting. AML regulations place banks under a legal obligation to take measures to prevent money laundering, including closing the accounts of customers on whom they cannot perform satisfactory due diligence. The penalty for non-compliance can be a fine in the billions of pounds or dollars, and the responsible bank employees face personal penalties including fines and being banned from working in a bank.

Banks are not crime-fighting agencies. They are profit-seeking businesses. Their decision-making is guided not by principles of justice but by revenues and costs, including the cost of risk. This means that, very valuable customers aside, they will be inclined to close the accounts of customers who present some *prima facie* risk of money laundering, even when they have evidence that falls well short of the standard required to gain a criminal conviction for money laundering.

When they close a customer’s account, they are making a business decision, not imposing a criminal penalty. So, they are free to do so without any evidence at all, let alone evidence that meets the standard of proof beyond reasonable doubt. Yet, even if having your bank account closed is not a criminal penalty, it is costly for the customer. It is a penalty, even if it is not a criminal one.

Most customers who are debanked ultimately find another bank to serve them. But it can be a slow and difficult process. Understandably, the banks approached are suspicious of a customer whose account has been closed by another bank. A debanked customer needs to go to unusual lengths to reassure his new bank and may suffer serious inconveniences and financial losses during a period of having no bank account. Being debanked is something that most people would surely pay a non-negligible sum to avoid (or, to put it the other way around, they would need to be paid a non-negligible sum to willingly accept it).

In 2021/22, 1,083 people in the UK were convicted of money laundering (HM Government 2023: 10). In the same year, banks closed the accounts of about 170,000 people who did not satisfy their AML due diligence (this being half of the 343,000 accounts closed in total). This means that about 169,000 people were effectively fined a non-negligible sum for money laundering on the basis of evidence inadequate even for arrest, let alone conviction. ‘Better that 169 innocent men be punished than a single guilty man go free’ is a peculiar inversion of the old adage.

The situation ought to be intolerable to a government committed to the rule of law. But the UK government has abandoned its commitment to the rule of law in such matters. Since Russia invaded Ukraine in early 2022, the UK government has been confiscating the property of Russians. And in doing so, it is merely following the advice of the FATF, of which it is a founding member. Recommendation #4 of the FATF’s 40 Recommendations for fighting money laundering advises governments to confiscate money from people it merely suspects of money laundering – or, as they put it, to establish ‘non-conviction-based’ confiscation regimes. In a 2012 paper on ‘best practice in confiscations’ the FATF tells its member governments that even acquittal by a court should not deter the government from confiscating someone’s property:

> Additionally, non-conviction based confiscation would be a useful tool in numerous other circumstances. These may include, but are not limited to, situations where property is found … but the perpetrator has been acquitted of the predicate offence because of insufficient admissible evidence or a failure to meet the burden of proof (FATF 2016: 6).

The benefits of AML regulations

If spending the proceeds of crime becomes more difficult, it will be less profitable and less will be committed. This is the rationale for criminalising money laundering. Money laundering is not harmful in itself. It is harmful only insofar as it encourages the crimes from which the money comes. Similarly, the justification for AML regulations must be that they reduce crime, and that the value of this crime reduction exceeds the cost of the debanking and compliance measures they entail.

Do they?

The illegal drugs trade is the single largest source of money laundering, accounting for about a quarter to half of the total[8] (UNODC 2011; Walker 2005). Do AML regulations reduce illegal drug dealing?

Between 1990 (when the FATF AML regulations began to come into force) and 2021, the number of illegal drug users around the world increased by 60%[9] and the number of deaths attributed to drug use more than doubled[10]. According to a 2023 report by the UK's National Crime Agency: 'From January 2022 to December 2022, cocaine prices have dropped by about 30% and heroin prices have fallen by about 33%. The prices are consistent with substantial quantities of the drugs being widely available and easily accessible'[11].

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8 See UNODC (2011), which puts the number at about 25%, and Walker (2005), which puts the number at about 50% (in Australia).

9 Statista (2023) *Addicts and consumers of illegal drugs worldwide 2021.* Accessed: 10 April 2024 (https://www.statista.com/statistics/274688/addicts-and-consumers-of-illegal-drugs-worldwide/).

10 Our World in Data (2022) *Opioids, cocaine, cannabis, and other illicit drugs*. Accessed: 10 April 2024 (https://ourworldindata.org/illicit-drug-use).

11 National Crime Agency (2023) *National Strategic Assessment (NSA) campaign 2023 – Drugs*. Accessed: 10 April 2024 (https://nationalcrimeagency.gov.uk/nsa-drugs).

Of course, illegal drug dealing might have increased even more if not for AML regulations. Many factors influence the demand for drugs and their supply, not only the ease with which drug dealers can launder the proceeds. But the burden of showing that the supply of illegal drugs would have been even higher falls on those who impose the burdens of AML regulations.

Alas, it is a burden the politicians and bureaucrats responsible for AML regulations are reluctant to bear. Executive Order 12866, issued by President Clinton in 1993, requires cost-benefit analysis of any regulation that has an ‘annual effect on the economy of $100 million or more…’. Yet the US Treasury has subjected its AML regulations to no such analysis, and nor has the UK’s FCA (which is under no such obligation). Why would agencies packed with economics PhDs avoid performing cost-benefit analysis on such a burdensome regulatory regime, even in violation of an executive order? Whatever the explanation, as things stand, there is no evidence that the well-known and large costs of AML regulations are offset by their benefits.

Pay to play

What should be done?

The FCA and US banking regulators understand that banks have responded to their threats by debanking rafts of innocent customers. And they regret it. As a solution, they suggest that banks take a 'risk-based approach' to closing customers' accounts (FCA 2024). Rather than debanking whole classes of customers who present a high *prima facie* risk, banks should treat each individual case on its merits.

I have already explained why this does not make sense for banks. The cost of gaining the information required to treat each case on its merits would exceed the value of the account after the bank had decided to keep it. These authorities are doing no more than telling banks to act against their commercial interests. This is baffling, considering that it is their own regulations that make their recommendation unprofitable.

If governments want banks to gather the information and perform the analysis required to determine the level of AML risk presented by individual customers, they should pay for it. This would prevent the cost of the investigation from making many customers unprofitable to serve.

It would also avoid the injustice of current arrangements. Police, judges, prison guards, and the other participants in the government's crime-fighting regime are paid for their efforts. The cost of paying them falls on taxpayers. This is reasonable because crime fighting is 'non-excludable': if it is supplied, everyone benefits from it. Society in general has an interest in fighting crime, so society in general should pay for it.

But the government makes an unexplained exception when it comes to money laundering. It recruits banks into fighting this crime not by paying them to do so, but by threatening to fine them billions of dollars if they do not. The cost falls not on society in general but on bank customers, who pay higher prices for banking services than they otherwise would or even have their bank accounts closed.

If the government adopted this policy, the cost to taxpayers would be slightly more than the current compliance cost to banks. To avoid the debanking problem, the government would need to pay not only for the due diligence banks now perform, but also for the due diligence they do not perform, because it is not worth the cost. If this cost were on average £1,000 for each of the 170,000 people now debanked on the basis of standard due diligence, that would be £170 million a year, which is a trivial addition to the £34 billion cost of current due diligence efforts. The policy would cause crime-fighting costs to fall on whom they should, and £170 million is a small additional cost to avoid the injustice of 170,000 people losing their bank accounts for no good reason.

Of course, there is an even better policy response to the debanking problem. The AML obligations imposed on banks have massive costs and no apparent benefit in reducing crime. The rational response is to abolish them or, at least, to scale them back, for example by going back to the pre-2017 regime. This is probably expecting too much of contemporary politicians, who find it difficult to stop regulating and who find it difficult to admit to profound policy errors.

But, here too, transferring the cost of AML efforts from bank customers to taxpayers may help. What is now a hidden cost would become politically visible. Taxpayers, most of whom are voters, are unlikely to be pleased by a three-fold increase in the cost of policing. And they are unlikely to see the sense in devoting two thirds of all spending on crime prevention to money laundering.

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