Part 3

The Human Element of an AML RegTech Ponzi Scheme

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The Human Element - an AML RegTech Ponzi Scheme

Recognising the problem of RegTech manipulation and 'the' ill-aligned global Anti-Money Laundering (AML) compliance framework is not easy. Discussion into the failed war on dirty money and the obvious cover up occurring globally through increased use of technology has seen few willing to take an active part. But there is hope. It is the hope that comes from recognising change is desperately needed – simply because too much is at stake and too many people are already suffering.

You, your family, and friends are the victims of the ultimate consequences of the failed war on dirty money. It is said that 'dirty money makes the world go round', but what is never spoken about is that it happens at your expense, not at the expense of those who illegally earn it. The criminals win, the good people lose. And they lose badly. It is an unfair outcome that is set to get worse.

Remembering why

Remember the 2008 financial crisis? If not, it was this incident that led to a knee jerk reaction which saw almost overnight sweeping banking reform. AML regulatory announcements surged by 492 percent between 2008 and 2015 [1]. What then followed was a wave of hefty penalties on banks with what was described as 'unsatisfactory AML compliance measures'.

To overcome the escalating AML compliance costs, significant investment in regulatory technology (RegTech) firms was endorsed – by Governments. IBM seized on the opportunity first, acquiring Promontory Financial Group with the primary aim to harness its team of 600 regulatory compliance experts to train 'Watson' – IBM's massive artificial intelligence engine [16]. Today, there are thousands of RegTech companies worldwide, propelling the RegTech market revenue from $8.7 billion in 2021 to what will be an estimated $44.5 billion by 2030 [18].

But a RegTechs' core objective is to streamline and expedite regulatory compliance tasks. That, in essence, is their primary and only function. However, nearly all RegTech companies now promise to combat, fight, and prevent diverse types of financial crimes. The glaring issue here is the notable lack of empirical and verifiable evidence proving their effectiveness in achieving such claims. This is particularly concerning given the estimated $2.9 trillion laundered globally each year [29].

Behold the RegTech Ponzi scheme – a direct way to leverage government backing to miraculously convince that their promises of making the world safer by combating, fighting, and preventing financial crimes are somehow true. Much like Ponzi schemes, RegTechs have used questionable return on investment (ROI) claims to attract even more funding, while taxpayers continue to suffer from unresolved money laundering issues.

Behold the inevitable human consequences

It would be naive to believe that the failed Anti-Money Laundering strategy, despite being in place for 35 years and backed by billions of dollars in investment, has no direct consequences on everyday citizens. With focus often aligned to sensational stories of money-motivated killings, threats, and luxurious asset freezes, the impact on ordinary citizens seems too mundane to investigate.

Yet, the consequences are widespread – seeing how Western banks remain major conduits for money laundering – despite custodians of public trust. We see innocent businesses and individuals unknowingly aide criminals who are banked, thus they remain part the legitimate economy. Innocent businesses and individuals unknowingly aid criminals every day, allowing them to be part of the legitimate economy.

Despite the investment, AML practitioners are ineffective in spotting money launderers, and many suffer low job satisfaction rates. Poorly informed policymakers misallocate public resources away from AML measures that they believe are good enough. Yet, there is little recognition as to why the wealth gap continues to widen between criminals (who rarely raise suspicions) and legitimate customers (who frequently trigger AML red flags). This we already know is increasing financial exclusion of legitimate customers – driven by high compliance costs. The obvious knock on effect here is how it exacerbates poverty, human suffering, and conflicts.

Still, for some it can be hard to envisage the everyday scenarios this relates to. So, let's look at a hypothetical scenario based on a real case reported by the All-Party Parliamentary Group (APPG) on Fair Business Banking in their 2024 De-Banking Report [37]: The collapse of Solar Horizons (with the RegTech Ponzi in full swing).

On a brisk Tuesday morning, the compliance team at a high street bank in London received a series of suspicious activity alerts from their newly upgraded RegTech solution. Enhanced with advanced algorithms and machine learning, it promised to identify potential future financial crimes with unparalleled accuracy. The alerts flagged multiple transactions made by Solar Horizons, a longstanding customer that manufactured solar water pumps in India and sold them to African farmers.

The team, led by a compliance manager, was surprised. Solar Horizons had been a customer for over a decade, known for its pioneering work in providing affordable irrigation solutions to drought-stricken regions in Africa. The company was instrumental in helping small farmers increase their crop yields by ensuring a reliable water supply.

The alerts

The Compliance team looked closer into the RegTech alerts that raised:

- Presence of high risk jurisdictions: The company was receiving funds from jurisdictions classified as high risk, such as Nigeria.
- Presence of network of intermediaries: The company had dealings with third-party distributors across multiple countries.
- Presence of a high risk industry: The company operated in the renewable energy industry that is generally said to have poor human rights in the field of health and safety of workers and the environment.
- Potential dual use goods involved: The company builds solar-powered water pumps that may involve high-performance materials, electronic components, or advanced engineering techniques that could be deemed as dual-use capabilities.
- Proximity to border: The company had recently moved its factory near the border with Pakistan where it had better access to suppliers and distribution channels.

Decision to de-bank

After reviewing the alerts and deliberation, the compliance manager, under pressure to keep the bank safe from potential fines and costly compliance measures, decided to err on the side of caution. The bank would de-bank Solar Horizons. The decision was swift, and Solar Horizons was informed that their company's accounts would be closed, advising the company to find other suitable banking arrangements within 60 days.

Mark Smith, environmental biology specialist and founder of Solar Horizons was stunned. He tried to explain the nature of the business and the importance of their work in Africa. However, the bank's decision was final, and there was no avenue for an appeal.

Collapse of Solar Horizons and Mark

As a consequence, Solar Horizons was left scrambling to find another banking partner. Meanwhile, their operations in India and Africa came to a grinding halt. Without a bank account, they could not pay their suppliers or receive payments from distributors. The production of solar water pumps stopped, and the distribution network collapsed.

Mark, the resolute founder of Solar Horizons, found himself plunged into unexpected financial distress, ultimately resulting in personal bankruptcy. For Mark, Solar Horizons was more than just a source of income; it was his life's passion, driven by a deep sense of purpose. The collapse of the business left an enduring emotional and psychological impact on Mark, manifesting in profound ways.

The weight of financial difficulties and the stress of managing a failing business strained Mark's personal relationship, fracturing connections with family, friends, and colleagues alike. The once vibrant network of support now strained under the weight of uncertainty and hardship.

The emotional toll of the business collapse was immense, leading to severe mental health issues. Mark grappled with overwhelming feelings of low self-worth, failure, inadequacy, and hopelessness as he faced an uncertain future, struggling to find meaning and purpose in the aftermath of the collapse.

The impact on small African farmers

The sole dependence on rain meant crop yields were highly susceptible to unpredictable and inconsistent weather patterns. Such uncertainty made it difficult to plan for future food needs, exacerbating food insecurity in the community. Without affordable irrigation solutions, poor crop yields would again lead to unstable incomes, preventing farmers from investing in better seeds, tools, or technologies that could improve their yields and income. This financial instability would again affect the broader economy as less money would circulate prohibiting investment in essential services like education and healthcare and impacting overall development, wellbeing, and self-worth.

Are we to blame?

The blame sits with everyone. It is as simple as that – we are all to blame – because whilst we choose not to hold your policymakers accountable for the inadequate AML regime they promote – then we allow thousands of similar case studies to unfold.

As many global and industry fed reports keenly highlight, an estimated $2.9 trillion is laundered globally each year [29], with the UK and the USA together accounting for 40% of all money laundering across the 36 OECD countries [31]. UK policymakers, often overlook economic crimes because they do not ‘bang, bleed, or shout’ [34]. This results in the illusion they do not impact on your wellbeing and security.

A lack of awareness by each one of us delivers a mere 0.6% of police officers in England and Wales to investigate fraud, money laundering, and other economic crimes [34]. You might be surprised to find that these crimes really do cost you the UK taxpayer is approximately £380 billion per year – 23 times greater than the cost of traditional crimes [34].

To maintain an illusion of control, policymakers willingly conceal the true scale of the problem behind the RegTech smoke screen they have created since 2015. Nearly a decade on its clear to now see how the RegTech Ponzi scheme has become an extremely dangerous investment.

So, while government-supported RegTech companies prosper, you, on the other hand, are increasingly vulnerable to de-risking or de-banking. Banks simply do not see you as ‘a valuable customer’ even though you likely bailed them out after the 2008 financial crisis and continue to fund their AML compliance failures. Still, we should remember that the banks are merely puppets to a much more greedy and dishonest master.

Looking forward

If history teaches us anything, it is to make sure we are prepared for what may happen again. Yet in this case, many have ignored the many critical learning points. Just as the government financial services regulators were unprepared to deal with past crises, we should not expect them to be any better equipped when the RegTech Ponzi Scheme collapses. A collapse likely to occur under pressure to prove the worth of the RegTech industry.

When it does, you, your children, your family, and friends will again be forced to foot the bill.

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