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**THE CASE FOR URGENT
AML/CFT MODERNIZATION**

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Financial institutions collectively spend billions each year on Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) compliance. Yet much of that investment is consumed by outdated, rigid examination practices that drain resources while doing little to address national security threats. AML/CFT modernization that strengthens national security is both urgently needed and entirely achievable.

Leadership at the U.S. Department of the Treasury has acknowledged this reality, calling for a fundamental overhaul of the AML/CFT framework. Treasury's vision emphasizes channeling resources toward the highest-risk areas, permitting the deprioritization of lower risks, and granting categorical exemptions where appropriate. The message is unmistakable: the status quo is unacceptable, and change must come now to enhance both effectiveness and efficiency for government and industry alike.

FROM COMPLIANCE PROCESS TO HIGH RISK IMPACT

The AML Act of 2020 (AMLA) was billed as the most significant reform to U.S. financial crime law in decades. Its intent was to modernize the AML/CFT framework, making it risk-based, focused on priority law enforcement needs, and open to information-sharing and technological innovation. Despite its ambitions, for a myriad of reasons, the AMLA has fallen short of expectations – not producing the results many had anticipated. Today, the majority of AML/CFT resources remain trapped in rigid, low-value practices: model validation testing, formulaic know-your-customer (KYC) reviews, and examinations of matters immaterial to national security risk. These obligations impose steep opportunity costs, diverting critical resources from higher-risk areas where innovation is essential.

Meanwhile, practices that *do* generate actionable insights—such as using high-quality open-source intelligence to uncover narco-terrorist financial activities or sanctions and trade controls evasion—are too often misunderstood by examiners as signals of control weaknesses. This misalignment discourages institutions from abandoning ineffective legacy practices in favor of innovative approaches that directly advance national security priorities.

Treasury has already highlighted this misallocation. AML/CFT modernization requires discarding low-value, legacy requirements in favor of outcome-driven practices that sharpen risk detection. Clear, coordinated examination standards grounded in objective measures of effectiveness are essential to break decades of bureaucratic inertia.

TOWARD REAL SECURITY

AML/CFT modernization that focuses on national security and other high risk areas must start with how regulators evaluate **transaction screening, transaction monitoring, customer due diligence, and export controls compliance**. In each of these areas, success should be measured by the institutions' use of high-quality open-source intelligence as a central control.

Transaction Screening

Effective risk leaders recognize that open-source intelligence—not government list screening—drives most blocked, reported, or rejected transactions. Examiners must move beyond narrow validation of name-matching against static lists, which adversaries have long since learned to evade. Instead, success should hinge on detecting and blocking unlisted entities majority-owned or controlled by, or operating on behalf of, sanctioned actors. Commerce Department Bureau of Industry and Security (BIS) listed parties and entities majority-owned or controlled by BIS-listed parties should be considered for transactions screening. Alerts should be flagged for investigation, and reported as suspicious activity related to export controls evasion, where merited.

Transaction Monitoring

National security risks often are present less from direct customer relationships and more through counterparties and correspondent banking ties—exposures identifiable in payments data. Both government and private-sector leaders acknowledge that open-source intelligence is the only proven tool for effectively and efficiently uncovering hidden sanctions and trade controls evasion. Already embedded in guidance, retrospective screening of transactions with high-quality open-source intelligence should become the benchmark for measuring how effectiveness on national security matters is monitored.

Customer Due Diligence

Customer Identification Programs (CIPs), customer screening, and KYC must be assessed by their ability to detect exposure to actors that are materially associated with sanctioned or trade-restricted parties. The effective use of open-source intelligence should become the standard for customer due diligence. It is widely recognized that the majority of national security-related client exposure stems from commercial relationships beyond the scope of current KYC questionnaires, adverse media and beneficial ownership checks.

Export Controls Integration

Since 2022, BIS has issued extensive export controls compliance guidance, often jointly with FinCEN, underscoring growing expectations for financial institutions. Successive administrations and Congress have emphasized export controls as a core national security interest. Yet, the financial sector has been slow to integrate export controls into compliance programs, treating the needed controls variously as low priority, optional or with minimal investment. This gap is a vulnerability that adversaries exploit. Institutions must incorporate export controls compliance as a mandatory element of AML/CFT programs, with effectiveness measured by their ability to detect and report possible evasion activity.

A SMARTER, RISK-BASED APPROACH

Not all institutions face the same level of exposure. Global systemically important financial institutions (G-SIFIs) carry fundamentally different risks than community banks. Treasury rightly calls for regulatory changes that reflect this reality, including categorical exemptions for low-risk institutions. Relieving small firms of undue burdens and large firms from misguided priorities allows compliance resources to be applied to where they matter most, while also relieving broader regulatory burdens.

THE WAY FORWARD

Without a fundamental shift in how AML/CFT program effectiveness is measured – from checking boxes on low-value tasks to rewarding outcome-driven results that reflect national security priorities – the U.S. risks wasting the opportunity to achieve a genuine win-win for both government and industry.

Treasury's call for urgent modernization is a wake-up call: the time for action is now. Examiners must be equipped with a new playbook – one that rewards what works, eliminates what doesn't, and reorients the system toward detecting and reporting the highest-priority risks.

AML/CFT modernization is not merely about efficiency; it is about national security. Every dollar wasted on low-value compliance tasks is a dollar not spent countering fentanyl traffickers, hostile non-state actors, or adversarial military powers. By embracing modernization, we can reduce costs, lessen burdens, and most importantly, ensure that AML/CFT fulfills its ultimate purpose: safeguarding the financial system and protecting national interests.

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This paper reflects insights from Kharon's work supporting compliance leaders at the world's largest financial institutions and corporates, and incorporates perspectives from those leaders on the challenges and opportunities for AML/CFT modernization.

ABOUT KHARON

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Kharon helps leading organizations identify a wide range of sanctions and compliance risks, critical to managing financial crimes, supply chain exposure, export controls, investment risk, and more. Powered by The Kharon Core – the premier global risk analytics engine—our solutions deliver essential insights needed for an all-encompassing perspective on illicit finance and other commercial risks.

The Kharon leadership team includes former senior officials from the U.S. Government who have leveraged their unique expertise to build a risk management solution that's trusted by the world's top financial institutions, global corporates, and professional services firms.

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