

Reforming the Watchtowers: A Call for Caution Not to Dismantle America's Financial Integrity Architecture

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On April 7th, 2026, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a [Notice of Proposed Rulemaking \(NPRM\)](#) intended to fundamentally reform financial institutions' anti-money laundering and countering the financing of terrorism (AML/CFT) programs under the Bank Secrecy Act (BSA).

According to FinCEN's [public release](#), the proposed rule introduces key reforms to AML/CFT program compliance and supervision, including:

- refocusing compliance obligations and expectations on effectiveness by distinguishing between deficiencies stemming from program design and implementation;
- reinforcing Treasury's belief that financial institutions are best positioned to identify and evaluate their illicit finance risks;
- empowering financial institutions to devote more attention and resources toward higher risks rather than toward lower risks;
- clarifying expectations related to certain program requirements and functions—including independent testing and audit functions—to ensure that examiners and auditors do not substitute their subjective judgment in place of financial institutions' risk-based and reasonably designed AML/CFT programs; and
- affirming FinCEN's central role in AML/CFT supervision, including through the introduction of a notice and consultation framework between Federal banking supervisors and FinCEN with respect to significant AML/CFT supervisory actions.

“For too long, Washington has asked financial institutions to measure success by the volume of paperwork rather than their ability to stop illicit finance threats,” said Secretary of the Treasury. “Our proposal restores common sense with a focus on keeping bad actors out of the financial system, not burying America’s banks in more red tape.”

Framing the proposed reform as a liberation from red tape—a shift from measuring “success by the volume of paperwork” to focusing on real threats—is questionable.

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While the change may be consistent with the Administration's priorities in general, it also weakens the regulatory architecture crucial to AML/CFT programs. In a wide context, it might be considered as a crucial brick removal from that regulatory architecture which establishes compliance in those areas.

It is important to note that change and reform is needed to improve the effectiveness of the system's defense lines and compliance barriers against prohibited finance. The current system has not functioned as needed and there are indications that maybe trillions of dollars are laundered globally each year, including terror funding, sanctions' evasion flows, crime related funds, tax evasion, etc. However, the proposed NPRM is not an example of a reform that strengthens the oversight mechanisms that stand between the world's most important financial system and the criminal networks, terrorist financiers, and sanctioned regimes who seek to exploit it.

Unfortunately, the FinCEN proposed rule is not an isolated policy choice. It is one more pillar in a structure of regulatory rollbacks that, together, constitute a consistent policy agenda of deregulation and the untightening of regulatory burdens, but with troubling future prices that may turn out too high.

I. The Starting Point: A System in Need of Reform

Any honest assessment of the anti-money laundering and counter-terrorist financing framework must begin with an uncomfortable acknowledgment: The current system, despite decades of development and enormous compliance expenditure, has not performed as intended. The United Nations Office on Drugs and Crime estimates that between \$800 billion and \$2 trillion are laundered globally each year, equivalent to approximately 2–5% of global GDP. Separately, [TRM Labs estimated](#) that illicit cryptocurrency activity reached a record \$158 billion in 2025, reflecting a sharp increase from the prior year and probably an all-time high.

Academic scholarship has arrived at similarly sobering conclusions. Mirko Nazzari and Peter Reuter, [writing](#) in *Crime and Justice* (2025), observe that despite the growing sophistication and expense of the global AML regime, “there is no evidence that money laundering is declining or becoming more difficult or expensive,” and that “major banks have repeatedly failed to meet their obligations, suggesting either insufficient commitment or a lack of the necessary skills and systems to comply.”

The IMF's 2023 Review of its AML/CFT Strategy similarly concluded that Money laundering (ML) as well as terrorist financing (TF) and the financing of the proliferation of weapons of mass destruction (WMD) or proliferation financing (PF), continue to pose a threat to IMF members' financial sectors and the broader economy by threatening the integrity and stability of a country's financial sector and external stability more generally.

These are not arguments against regulation. These are arguments for better regulation; for reforms that should be more risk-sensitive, more outcomes-focused,

and more effectively designed to increase compliance and improve efficiency of the control environment. The fundamental question posed by the current wave of U.S. regulatory processes is not whether reform is needed. It is whether the reforms being pursued are calibrated to strengthen the system or might unintentionally weaken the system with the initial motivation of modernization, increasing effectiveness and a consistent deregulation approach.

That distinction is the lens through which the FinCEN proposed rule of April 7th, 2026, and the broader regulatory agenda of which it is a part, must be evaluated.

II. The Principles That Must Not Be Compromised

Before turning to the specifics of the current proposal, it is worth articulating the principles that international standard-setters, academic experts, and financial regulators have identified as non-negotiable in any reform of the AML/CFT framework. These principles provide a normative benchmark against which current proposals should be measured.

Effectiveness over formalism, but with clear standards. The FATF's Methodology for assessing AML/CFT effectiveness explicitly calls for outcomes-based evaluation rather than technical compliance. A shift from box-ticking to genuine risk management is consistent with international best practice, but only if accompanied by clear, enforceable definitions of effectiveness and robust mechanisms for supervisory challenge.

Supervisory independence as a non-negotiable foundation. The Basel Committee on Banking Supervision's revised Core Principles (2024) are [unequivocal](#): Principle 2 requires that “the supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy, and adequate resources.” The principle is not aspirational: it is the de facto global minimum standard for effective banking supervision, assessed by the IMF and World Bank in every Financial Sector Assessment Program.

Transparency of ownership as a cornerstone of illicit finance detection. [FATF Recommendation 24](#) on beneficial ownership transparency has long been identified as one of the most critical tools in disrupting money laundering and terrorist financing through shell company structures. Rolling back Ultimate Beneficiary Ownership (UBO) requirements removes an investigative foundation that law enforcement agencies depend upon to trace illicit flows.

Proportionality, not abdication. Risk-based supervision, the principle that supervisory resources should be proportionate to risk, is sound doctrine. But proportionality requires the retention of supervisory judgment. A framework that prevents examiners from challenging a bank's own risk classification does not

implement proportionality; it delegates it to the regulated entity, potentially a structural conflict of interest that the supervisory system was designed to address.

International regulatory coherence. As the Financial Stability Board (FSB) has repeatedly warned, fragmented and inconsistently implemented regulatory frameworks create opportunities for regulatory arbitrage in cross-border financial markets—vulnerabilities that may also be exploited by sophisticated illicit finance networks. Unilateral relaxation of standards by the world's largest financial system carries systemic externalities that extend well beyond U.S. borders.

III. The April 2026 Proposed Rule: Reform or Retreat?

Against these principles, the FinCEN Notice of Proposed Rulemaking of April 7th, 2026 (Docket No. FINCEN-2026-0034) presents a mixed and troubling picture.

The rule's shift toward an “effectiveness” standard is not objectionable. There is genuine merit in the proposition that AML compliance has become excessively procedural, and that resources should be directed toward genuinely high-risk activity. The FDIC Chairman's [characterization](#) of the proposal as “perhaps the most important of the reforms Congress envisioned in the AML Act” may reflect a legitimate legislative mandate under the Anti-Money Laundering Act of 2020.

The concern lies elsewhere—specifically in three provisions that, taken together, represent not a modernization of supervision but a structural weakening of the oversight apparatus.

First, the reform's enforcement threshold requires demonstration of a significant or systemic failure before regulators may take meaningful supervisory action. This threshold, undefined precisely in the proposed rule, sets a high and vague bar that will predictably chill examiner initiative and benefit institutions that maintain technically adequate programs while tolerating meaningful compliance gaps.

We raise a shared concern that the proposal could make it more difficult for regulators to intervene when financial institutions maintain weak AML controls. The announced shift toward an effectiveness-based AML/CFT framework could reduce regulatory clarity and make supervisory intervention more dependent on demonstrating broader or systemic compliance deficiencies, which will not always be unequivocal.

Second, and most structurally significant, the rule explicitly instructs that “examiners do not substitute their subjective judgment in place of financial institutions' risk-based and reasonably designed AML/CFT programs.” This language constrains the professional judgment that is the central purpose of an examination. The history of major AML failures and sanctions evasions is not a story of aggressive and overzealous regulators. It is a story of severe failures of institutional weaknesses, enabled by inadequate oversight.

The proposed rule's emphasis on institutional discretion also invites regulatory arbitrage. In an environment with heavy cost pressures, the temptation to reclassify risk downward is structural, not hypothetical.

Third, the rule introduces a notice and consultation framework requiring federal banking supervisors to provide FinCEN's Director with at least a 30-day advance written notice before initiating significant AML/CFT supervisory or enforcement actions. This provision raises a concern of institutional design significance: It inserts a Treasury bureau into the enforcement decision-making of independently chartered supervisory agencies, potentially creating a difficulty in the supervisory chain.

IV. The Subordination of Independent Supervisors

The structural implications of the FinCEN consultation requirement deserve careful attention. The Federal Deposit Insurance Corporation (FDIC), the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA) are not administrative sub-offices. Each holds an independent statutory mandate, established by Congress, to supervise the institutions under their jurisdiction and to take corrective action where warranted. Their independence is not merely an organizational feature; it is, under the Basel Core Principles, a fundamental requirement of effective supervision.

The 30-day advance notice requirement transforms enforcement from a professional supervisory determination into a consultative process subject to Treasury review and "input." While the proposal characterizes this as "affirming FinCEN's central role in AML/CFT supervision," the supervisory process becomes vulnerable and decision making might be challenged if not rest on examiner independence and institutional expertise only.

This concern is not speculative. The recent history of the Public Company Accounting Oversight Board (PCAOB), discussed below, illustrates what happens to an oversight body when its independence is eroded through budget cuts, leadership appointments, and possibly, implicit political alignment: enforcement declines, accountability is challenged, and the regulated community might adjust its behavior accordingly.

What is especially notable, and deserves to be noted explicitly, is that the FDIC, OCC, and NCUA accepted this structural shift without visible public dissent. All three agencies issued a coordinated joint proposed rule on April 7th, 2026, explicitly endorsing alignment with the FinCEN framework and the new consultation structure. No agency published a dissenting statement. No commissioner invoked the agency's independent mandate as a basis for institutional criticism or disagreement.

V. A Pattern of Parallel Rollbacks

The April 2026 NPRM does not stand in isolation. It is the most recent element in a series of regulatory changes that, considered together, might constitute a systematic reduction in the transparency and accountability infrastructure of U.S. financial markets.

Beneficial Ownership Transparency. In March 2025, FinCEN issued an interim final rule exempting all U.S. domestic companies and U.S. persons from beneficial ownership reporting requirements under the Corporate Transparency Act (CTA), effectively narrowing a law passed with broad bipartisan support in 2020 to address the well-documented use of anonymous shell companies for money laundering, sanctions evasion, and terrorist financing. The FATF Recommendation 24 standard, which the CTA was specifically designed to implement, recognizes that without UBO transparency, financial intelligence agencies are structurally limited in following illicit funds through complex ownership chains. The Treasury framed the rollback as relief for small businesses. Its practical effect is the neutralization of a powerful investigative tool available for tracing illicit finance through U.S. corporate structures.

Audit Oversight. The Public Company Accounting Oversight Board (PCAOB) established by Congress following the Enron and WorldCom accounting scandals under the Sarbanes-Oxley Act of 2002 has experienced significant institutional contraction. Its 2026 budget was substantially reduced, its chairperson was replaced at the request of SEC Chairman, and legislative proposals to abolish the board entirely were only narrowly removed. The consequences are already measurable: according to public information, PCAOB enforcement actions declined 27% in 2025, and monetary penalties fell that year by 50%. Protecting the enforcement capacity of this audit gatekeeper is essential to its adequate positioning to detect accounting irregularities that can both mask and facilitate financial crime.

Securities Enforcement and Reporting. According to Cornerstone Research, accounting and auditing enforcement actions in 2025 [fell to their lowest level in nine years](#), while monetary settlements declined sharply as well. Concurrently, the SEC is tracking a proposal to replace mandatory quarterly financial reporting (Form 10-Q) with semi-annual disclosures (Form 10-SAR), reducing the frequency of public financial information from four times per year to twice. While there are legitimate academic debates about the short-termism induced by quarterly earnings cycles, halving the frequency of mandatory disclosure doubles the window during which financial deterioration, irregular transactions, and emerging risks can accumulate without public visibility. Lower market discipline will always be the preferred background for illicit financial activities and financial crime as well.

VI. The Systemic Risk of Parallel Deregulation

Individually, each of these reforms admits a plausible policy rationale. Collectively, they present a different picture. Financial crime does not operate in silos. Sophisticated money laundering operations and terrorist financing networks exploit multiple regulatory gaps simultaneously, combining anonymous corporate structures, weak AML screening, reduced audit scrutiny, and attenuated market disclosure in coordinating evasion strategies. The [IMF's 2023 background paper](#) on financial integrity and financial stability emphasized that financial integrity failures, including weaknesses in AML/CFT supervision, can destabilize banks through deposit outflows and broader spillover effects, potentially threatening systemic financial stability.

Removing multiple layers of the compliance architecture in parallel does not proportionately reduce regulatory burden; it creates compounding vulnerabilities.

For example, there is also an international aspect to consider: [Executive Order 14114](#) expanded secondary US sanctions, holding foreign financial institutions liable to a strict liability standard for exposure to Russia's military-industrial base. Regulatory processes, discussed in this paper, might reduce the same domestic compliance infrastructure which should detect and report such exposure. A domestic AML regime that constrains examiner judgment, decreases UBO transparency, and weakens auditors and supervisory independence, might not be the optimal platform from which to project this kind of secondary sanctions enforcement abroad.

VII. Conclusion: The Standard for Adequate Reform

The reforms documented in this analysis should not be categorically opposed. The legitimate objectives they strive for—risk-based compliance, reduced administrative burden, greater institutional flexibility, alignment with the Anti-Money Laundering Act of 2020—are shared by serious practitioners and scholars. The critique offered here is not against reform. It is against reform that fails to satisfy the core conditions under which the existing framework's weaknesses can be addressed without creating greater vulnerabilities.

Those conditions are not obscure. They are codified in the Basel Core Principles, articulated in FATF Methodology, examined in IMF FSAPs, and supported by academic literature on the relationship between financial integrity, supervisory independence, and systemic stability. Those fundamental conditions require, at minimum, that reforms preserve examiner independence; maintain meaningful standards for regulatory enforcement; protect beneficial ownership transparency; and sustain internationally coherent supervisory frameworks.

Proposals currently advanced do not, on balance, satisfy those conditions.