



Structural Changes in Pakistan's Financial System Post-FATF

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Abstract: *This research work explores the profound structural changes undergone in the financial system of Pakistan in response to its topsy-turvy journey on the Financial Action Task Force (FATF) gray list. Beginning with an in-depth analysis of FATF's recommendations, the study also investigates the criticisms surrounding the FATF mechanism, including concerns about inconsistency, politicization, and potential geostrategic influences. The paper also highlights Pakistan's regulatory enhancements, legislative reforms, and adoption of a risk-based approach to combating the financing of terrorism and anti-money laundering measures. The pinnacle of this transformative process is the successful exit of Islamabad from the FATF gray list in October 20-21, 2022. This research contributes valuable insights into the dynamic relationship between national regulatory reforms, international financial governance, and the broader implications for the economic stability and global standing of the country.*

Key Words: Money Laundering, Terror Financing, Gray List, Structural Reforms, Risk-based Approach

Introduction

Since 2018, Pakistan has made significant structural changes in its financial system as a response to the challenges posed during its inclusion on the Financial Action Task Force (FATF) gray list. The FATF, an intergovernmental organization, aims to combat money laundering and terrorist financing by setting global standards and promoting the effective execution of these standards across jurisdictions. The inclusion of Pakistan in the FATF gray list prompted a series of structural reforms in its economic

structure, leading to notable transformations in its financial landscape.

The initiation of the FATF journey in Pakistan was marked by several concerns raised by the international community regarding combatting the financing of terrorism (CFT) measures and the effectiveness of its anti-money laundering (AML). To address these structural lacunae, FATF provided a set of recommendations to Pakistan. These recommendations spanned various areas, including regulatory enhancements, legal reforms, improvements in financial supervision, and subsequently the adoption of

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a risk-based approach to AML/CFT measures (Rahman & Ahmed, [2023](#)).

However, criticism of the FATF mechanism has been voiced by various quarters since its establishment. Some critics argue that the evaluation process may lack consistency and transparency, leading to disparities in outcomes for different countries. The subjectivity in the potential geopolitical considerations in evaluations and interpretation of AML/CFT standards have also been areas of concern. Additionally, several concerns have also been raised about the impact of stringent AML/CFT regulations on the financial inclusion of the countries and the potential unintended consequences of such measures (Hasan, [2021](#)).

Pakistan, in response to several recommendations from FATF and under intense regional and international scrutiny, embarked on a journey of structural changes in its financial system. Legislative reforms were undertaken by the country to strengthen its legal framework, and financial institutions such as the State Bank of Pakistan (SBP), Federal Board of Revenue (FBR) and the Securities and Exchange Commission (SECP) underwent enhanced regulatory measures and supervision. The risk-based approach became central to the strategy, allowing financial institutions to more targeted interventions in areas with higher risks of money laundering and terror financing (Rana, [2022](#)).

The culmination of this transformative process in the financial system occurred in October 2022 when Pakistan successfully exited the FATF gray list. This achievement signifies the commitment of the country to implementing vigorous AML/CFT measures and aligning itself with FATF standards. The successful exit holds profound implications for the economic stability, financial system, and global standing of Pakistan (Hussain, [2022](#)).

This journey, from facing FATF scrutiny to implementing comprehensive economic reforms and eventually exiting the gray list,

underscores the dynamic nature of international financial governance. As Pakistan emerges from this chapter successfully, it stands poised to contribute valuable insights into navigating FATF's challenges of maintaining financial integrity while fostering economic inclusivity and growth (Sherani, [2022](#)). The following section will explore the various facets of the financial transformation of Pakistan, shedding light on the successes achieved, lessons learned, and the ongoing commitment to a transparent and secure financial environment.

Overview of FATF and Its Role in Role in Global Financial Regulations

The Financial Action Task Force (FATF) is an intergovernmental organization that was established back in 1989 to combat terrorist financing and money laundering. The primary goal of the FATF is to set international standards and regulations and promote effective execution and implementation of operational, legal, and regulatory measures for combating terror financing, money laundering, and other related threats such as weak regulatory oversight of the integrity of the international financial system. Some of the important aspects of FATF and its role in global financial regulations include:

Establishment and Membership

The FATF was created by the G7 (Group of Seven) in 1989 in response to global growing concerns about the use of the international and financial system for illicit activities. It is a policy-making body comprising members of 39 member countries, including the European Commission and the Gulf Cooperation Council.

Role and Objectives

The primary role and objective of the FATF is to set standards and promote the implementation of operational, legal, and regulatory measures to combat terror financing, money laundering, and proliferation financing. The FATF suggests

recommendations, which are a set of comprehensive financial measures that countries are encouraged to adopt and implement. These recommendations are periodically updated to address emerging and changing challenges and risks.

Mutual Evaluations

Member countries are subject to mutual evaluations, where their AML/CFT regimes are assessed for compliance with FATF or international standards. The evaluations are conducted by FATF members and focus on a legal framework, regulatory measures of the country, and the effectiveness of its AML/CFT systems.

Blacklisting

The FATF maintains a list of countries that are deemed to have financial lacunae or strategic deficiencies in their AML/CFT regimes. Countries on the FATF blacklist, also known as the "Non-Cooperative Countries or Territories (NCCTs)," may face international restrictions and sanctions from international trade regimes.

Recommendations and Guidance

In addition to the core recommendations, the FATF also issues guidance on several issues to NCCT jurisdiction to assist countries in implementing effective measures. The FATF works closely with numerous other international bodies, such as the World Bank, the United Nations, and the International Monetary Fund, to promote global cooperation in combating financial crime.

Global Influence

The standards and recommendations of the FATF have a significant impact on global financial jurisdiction and institutions. Many countries across the world align their national regulations and laws with FATF standards to avoid financial and reputational risks.

Adaptation to Emerging Risks

The FATF continually adapts its standards to address emerging and new risks, including those associated with cryptocurrencies, virtual assets, and new technologies that could be exploited for terrorist financing and money laundering (Tamplin, [2023](#)).

Exploring Financial Revamps: States Revitalizing After FATF Evaluation

Several countries have undergone or are in the process of structural revamping or financial reforms in response to post-FATF scrutiny. It's important to note that the status of countries' compliance with FATF standards can change, and new developments and adaptation of emerging risks may have occurred with every passing day. The following section will explain the examples of countries that have faced or are facing financial reforms in the context of FATF scrutiny:

Pakistan

Pakistan has been on and off the FATF's "gray list" due to concerns related to terrorist financing and money laundering. The timeline of Pakistan's inclusion in gray-listing includes February 2008 to June 2010, from February 2012 to February 2015, and from June 2018 to October 2022. The country has implemented various structural reforms in its legal and regulatory framework to address FATF recommendations and maintain international standards. This also includes enhancing its AML/CFT measures (Shah et al., [2023](#)).

Iran

Iran has been facing scrutiny from the FATF and on the High-Risk Jurisdictions subject to a Call for Action (blacklist) along with North Korea and Myanmar for a decade, primarily related to concerns about money laundering and terrorist financing. Some of the outstanding issues of the FATF Action Plan on Iran include criminalizing terrorist financing, freezing terrorist assets, installation of an

independent financial intelligence unit, etc. The country has engaged in numerous reforms to improve its AML/CFT framework, however, its status on the FATF list has been subject to periodic reviews (Beizayi, [2023](#)).

Turkey

Turkey has been on and off the FATF's "gray list" since 2011 and made significant progress actively in improving its AML/CFT regime in response to FATF evaluations and recommendations. The compliances include the installation of a financial intelligence unit, reporting of suspicious financial transactions in several enterprises, tipping off the transactions and by-passing confidentiality, extradition, and mutual legal assistance, etc. Moreover, reforms also include updates to legislation processes and regulations to align with regional and international standards set by the FATF. Turkey is still on FATF gray list as of 2023 with 23 other countries (Singh, [2023](#)).

Myanmar

Myanmar has been facing scrutiny from the FATF and on the High-Risk Jurisdictions subject to a Call for Action (blacklist) since the start of the twenty-first century with a timeline for "black-list" of June 2001 to October 2006 and from October 2011 to February 2016. Moreover, for "gray-listing" the timeline includes from February to October 2016, and again from February 2020 to October 2022. Burma is still emplaced on the FATF blacklist with Iran and North Korea as the country is facing several challenges related to financial crimes and money laundering, leading to its inclusion in the FATF process. The country has been actively working on legal and regulatory reforms to strengthen its AML/CFT mechanism (Islam, [2022](#)).

Malta

Some serious strategic deficiencies were identified by the FATF regime in Malta in June 2021 related to the pursuit of tax-based

money laundering cases utilizing financial intelligence, the detection of inaccurate information on company ownership, and sanctions on several gatekeepers who failed to obtain accurate beneficial ownership information. However, Malta has made significant efforts to enhance its AML/CFT measures to comply with FATF standards. Malta pledges to work with MONEYVAL to continue to sustain its improvements in its AML/CFT system (Wellbank, 2022).

Pakistan's Financial Regulatory Landscape in the Pre-FATF Era

Pakistan falls in the category of those developing countries with the under-documentation or non-documentation of economic activities, stimulating Islamabad's frequent inclusion in the FATF gray list. The non-documentation of Pakistan's economy can be linked to several issues that are a source of concern to the FATF:

Money Laundering Risk

The under-documented or non-documented economic activities can provide several opportunities for money laundering. Without proper oversight and documentation, it becomes easier for illicit funds and informal money transfers to be integrated into the economic system of the country.

Terrorist Financing Risk

The undocumented and informal economic sectors may also be vulnerable to exploitation for terrorist financing purposes. The lack of a transparent mechanism makes it difficult for authorities to prevent or track the movement of funds from being used to support terrorist activities (Khan, [2023](#)).

Weak Regulatory Oversight

The informal economic sectors often operate with limited regulatory oversight. Subsequently, this can result in weak enforcement of Counter-Terrorist Financing (CTF) and Anti-Money Laundering (AML)

regulations, making it challenging for law enforcement authorities to first detect and then prevent illicit financial activities.

Tax Evasion and Illicit Financial Flows

Non-documentation is also often associated with and provides room for tax evasion, as individuals and businesses operating in the informal sector may not report their full monthly pay or income taxes. This can facilitate illicit financial flows and contribute to revenue losses for the government.

Limited Transaction Monitoring

In the absence of proper documentation in the country, financial transactions may also go unmonitored. This lack of visibility in the financial sector makes it quite difficult for law execution and enforcement authorities to implement effective transaction monitoring and surveillance systems to detect fishy or suspicious activities.

Challenges in Beneficial Ownership Identification

Non-documented economic activities can pose several challenges in identifying beneficial ownership of assets and companies. This lack of transparency makes it difficult to trace the true owners of businesses and assets, increasing the risk of misuse for illicit purposes.

Informal Money Transfer Systems

Non-documented sectors may also rely on informal money transfer systems that operate outside the regulated financial channels. These informal money transfer systems can be exploited for terror financing and money laundering (Dar, 2022).

Addressing the issues related to non-documentation of the economy is a key component of efforts in Pakistan to comply with FATF standards. The country is required to implement measures to strengthen regulatory frameworks, enhance transparency, and improve oversight to mitigate different risks associated with non-

documented economic activities. This includes reforms in areas such as transaction monitoring, beneficial ownership reporting, and regulatory enforcement. As Pakistan continues to take steps to address these issues, it aims to demonstrate its commitment to combating financially driven crimes and to meet the international monetary standards set by the FATF.

Events Leading to Pakistan's Inclusion in FATF Gray List

The inclusion of Pakistan in the FATF gray list is the result of several events and identified financial lacunae (weaknesses) in its CTF/AML frameworks. The process leading to inclusion typically involves evaluations, assessments, and determination by the FATF based on identified structural deficiencies. The following section will first explain the events and later the events and structural weaknesses that contributed to the inclusion of Pakistan in the FATF gray list:

Increased Scrutiny

The FATF, a global body monitoring financial systems, undertakes routine assessments of both member and non-member countries to gauge their adherence to CTF/AML standards. The intensified scrutiny faced by Pakistan since 2018 resulted from substantial concerns regarding the efficacy of its CTF and AML frameworks. This structural scrutiny is pivotal for maintaining the integrity and transparency of the regional and international financial system, with the FATF serving as a crucial international watchdog. The assessment process is comprehensive, evaluating the stoutness of regulations and mechanisms of the country to combat financial crimes. In the case of Pakistan, the spotlight was specifically cast on the CTF and AML regimes, necessitating a thorough examination of their effectiveness by the FATF regime. This increased scrutiny signifies the commitment of the global community to curbing illicit economic activities and ensuring nations implement stringent

measures to safeguard against terror financing and money laundering. Hence, the evaluation process aims to foster international cooperation and enhance financial security in combating these threats.

Global Terrorism Financing Concerns

The FATF, working in conjunction with regional and international partners, has raised massive apprehensions regarding the plausible exploitation of the financial system of Pakistan for terrorism financing. This heightened global concern stems from the undeniable presence of militant groups and intricate geopolitical contexts in the region. The regional and international community recognizes the important role financial systems play in hindering or facilitating terrorist activities, making the assessment of the financial landscape of Pakistan crucial. Given the complicated web of continuously evolving geopolitical dynamics, the risk of terror financing becomes more pronounced. The FATF, as a global watchdog, is keenly aware of the potential negative consequences of inadequately monitored financial systems regionally and globally to harbor militant groups. The collaboration with regional and international partners underscores the gravity of the terror financing concerns, emphasizing the need for comprehensive measures to thwart any use of the financial infrastructure for militant-related activities. This collective concern amplifies the urgency for international cooperation and stringent regulatory measures to ensure the vigor of the financial mechanisms of Pakistan in preventing terrorism financing (Karim & Hayat, 2022).

Gray List Placement (2018)

June 2018 marked a significant turning point for Pakistan as it found itself on the FATF gray list following a comprehensive assessment of its CTF/AML mechanisms. The gray list status should not be considered as merely a designation but a consequential signal indicating structural deficiencies in the

financial systems of the country, posing potential risks to the global financial order. The positioning of Pakistan on the gray list is a multidimensional reflection of the concerns of the international community. It also underscores the necessity to address and resolve identified vulnerabilities promptly. Pakistan's inclusion triggers a domino effect, impacting the financial and economic credibility of the country on the global stage. The FATF, by placing countries on the gray list, aims to compel systemic and regulatory changes, fostering the national commitment to rectify structural deficiencies that could compromise the integrity of the international financial system. The response of Pakistan to this listing becomes pivotal in restoring international confidence by mitigating risks in its financial mechanisms. Thus, the gray-listing becomes a catalyst for comprehensive economic reforms, demanding a transparent and proactive approach to regain international standing.

Action Plan Implementation

Following Pakistan's inclusion in the FATF gray list in 2018, it faced a compelling mandate to first formulate and then execute a comprehensive national action plan aimed at rectifying the identified deficiencies in its CTF/AML mechanisms. This inclusion phase involved a strategic approach to meet the stringent regional and international standards set by the FATF. The national action plan, a pivotal document in the financial reform journey of Pakistan, comprised specific measures designed to address the identified structural shortcomings. Moreover, Pakistan also delineated clear timelines, introducing an element of urgency and accountability in the execution process. The detailed framework of the national action plan ensured that Pakistan undertook tangible steps toward FATF compliance, fostering national transparency and demonstrating a commitment to aligning with international regulatory standards. This phase also reflects both a corrective initiative and a proactive stance to enhance financial

integrity. By adhering to the national action plan, Pakistan aimed to mitigate immediate financial concerns and aspired to build a resilient financial framework, securing its standing and earning back international trust within the global financial community (Singh, [2022](#)).

Financial Lacunae Leading to Inclusion

Weaknesses in Legal Framework

Pakistan faced scrutiny due to numerous identified weaknesses in its legal framework, particularly concerning CTF/AML aspects. The structural deficiencies centered on inadequate measures in criminalizing terrorist financing and money laundering activities. Specifically, structural gaps in the legal framework became superficial, pointing to various areas where necessary legislation was either insufficient or absent. The assessment highlighted the need for comprehensive rules and regulations that explicitly criminalize money terrorist financing and laundering, ensuring a comprehensive legal deterrent against such heinous financial crimes. Addressing these structural deficiencies requires a strategic overhaul of the legal system, encompassing the execution of laws that precisely prohibit and define terror financing and money laundering. Furthermore, legal amendments should align with international financial standards, fostering a more protected financial environment. By fortifying its legal framework, Pakistan aims to meet international expectations and strengthen its domestic mechanisms, creating a more resilient defense system against illicit financial activities. The ongoing structural efforts to bridge these legal gaps underscore a commitment to enhancing the financial integrity and global standing of the country.

Ineffective Regulatory Oversight

Pakistan also faced challenges related to ineffective regulatory oversight of its financial institutions including the SBP and SECP. The concerns identified by the FATF revolved

around the inadequacies in enforcement mechanisms and supervisory measures, contributing to structural vulnerabilities in the overall financial system. The systemic deficiencies in regulatory oversight underscored the need for a substantial strengthening and reassessment of supervisory practices. Insufficient checks and balances in monitoring financial institutions in Pakistan could potentially allow illicit activities to go unchecked. To address this, Pakistan had to prioritize the enhancement of regulatory frameworks, of its financial mechanism, empowering supervisory bodies in the country to conduct thorough structural examinations and enforce compliance. Moreover, efforts should also focus on the implementation of more stringent oversight mechanisms, ensuring that financial entities in the country adhere to established standards and regulations. This includes bolstering the capabilities of regulatory bodies to effectively detect anomalies, monitor transactions, and take timely enforcement actions. By revitalizing regulatory oversight, Pakistan aimed to comply with international standards and foster a resilient financial ecosystem (Ahmed, [2021](#)).

Non-Compliance with FATF Recommendations

Pakistan also faced significant scrutiny for its non-compliance with various FATF recommendations, revealing critical gaps in the country's CTF/AML efforts. The identified shortcomings encompassed several areas such as beneficial ownership identification, customer due diligence, and the several reports of suspicious transactions. The deficiency in customer due diligence highlighted structural vulnerabilities in the verification processes for different entities and individuals engaging in financial transactions. Moreover, numerous lapses in beneficial ownership identification indicated a lack of transparency and efficiency in understanding the ultimate beneficiaries of those financial activities. Additionally,

inadequate reporting of suspicious transactions raised concerns about the effectiveness of monitoring mechanisms. Addressing these non-compliance issues necessitates comprehensive reforms. Since then, Pakistan enacted and enforced regulations that align with FATF recommendations, ensuring robust customer transparent beneficial ownership disclosure, due diligence procedures, and prompt reporting of suspicious transactions.

Inadequate Implementation of UN Security Council Resolutions

Pakistan also faced concerns regarding the inadequate execution of the United Nations Security Council (UNSC) resolutions aimed at preventing terror financing. The scrutiny revealed several shortcomings in the measures taken to align with these resolutions, signaling a need for substantial improvements in the CTF/AML mechanisms of the country. The identified issues by the FATF encompassed a lack of adequate measures to fully comply with UNSC resolutions, particularly those targeting the prevention of terror financing. This deficiency also raises alarms about potential gaps in the regulatory and legal frameworks necessary for curbing financial support to terrorist activities. Addressing these concerns of inadequate implementations required a comprehensive approach involving regulatory enhancements, legal reforms, and vigorous enforcement mechanisms. Pakistan has prioritized aligning its financial systems with the specific requirements outlined and directed in UNSC resolutions, ensuring an active stance against the financing of terrorism (Khan & Arif, [2023](#)).

Cross-Border Movement of Currency

Pakistan confronted several challenges linked to the cross-border movement of different currencies, revealing structural vulnerabilities in the efforts of the nation to prevent the flow of funds across its borders. The recognized weaknesses by the FATF

underscored the need for more effective measures to monitor and control currency movements across borders. The structural issues identified revolved around the inadequacy of the existing system to curtail the illicit flow of funds. Insufficient monitoring and control mechanisms could potentially allow for the unauthorized movement of currency, creating opportunities for terror financing money laundering, and other financial crimes. This situation necessitates a strengthening of regulatory frameworks and a comprehensive reassessment to address these weaknesses. To counteract these challenges, Pakistan implemented vigorous measures such as improved monitoring systems, enhanced border controls, and stricter reporting requirements for cross-border financial transactions (Bukhari et al., [2022](#)).

Terrorist Financing Prosecutions

Pakistan also faced scrutiny due to insufficient progress in prosecuting entities and individuals involved in money laundering and terrorist financing, sparking nationwide concerns over the effectiveness of enforcement measures. Moreover, the lack of tangible outcomes in legal proceedings and regulations underscored the need for substantial advancements in different efforts of the country to combat terrorist financing. The identified issues point to potential structural gaps in investigative capacities, legal frameworks, and collaboration between relevant national authorities. A robust legal response is important to ensure that those engaged in terrorist financing across the country face severe consequences for their actions. The absence of tangible progress in prosecutions indicates challenges in legal procedures, gathering evidence, or coordination among enforcement agencies. To address prosecution-related concerns, Pakistan has prioritized the enhancement of its legal and regulatory infrastructure, ensuring that it facilitates effective

prosecutions, investigations, and convictions related to terrorist financing. This involves improving cooperation between relevant entities, bolstering the capabilities of law enforcement agencies, and streamlining legal procedures to expedite cases. The ongoing efforts in the prosecution domain highlight the dedication of the nation to achieving tangible outcomes in the legal battle against CTF/AML.

Non-Transparency in Beneficial Ownership

Pakistan faced scrutiny for the identified lack of efficiency and transparency in beneficial ownership information, particularly within business and corporate structures. The structural deficiencies highlighted a significant gap in ensuring that the true owners of companies and assets are known and disclosed, emphasizing the need for substantial improvements in transparency-related measures. The national concerns centered on the potential misuse of corporate-cum-corporate structures to conceal the actual beneficiaries of businesses and assets, creating opportunities for several stakeholders to carry out illicit financial activities. The identified lacuna of non-transparency emphasizes the importance of comprehensive disclosure mechanisms to ensure accountability and prevent misuse in financial structure. To address these issues, Pakistan prioritized reforms that strengthen the transparency of beneficial ownership. This includes enhancing regulatory oversight, implementing robust reporting requirements, and establishing mechanisms to disclose and verify the true owners of companies and assets. Such transparency measures align with international standards and foster a more accountable-driven business environment (Akhtar et al., 2023).

Limited International Cooperation

Pakistan also faced challenges in information exchange and international cooperation, highlighting structural limitations in

collaborative efforts with international organizations and other regional countries to combat cross-border financial crimes. The identified shortcomings by the FATF underscore the crucial need for improvements in fostering and strengthening effective partnerships on the global stage. The noted issues pertain to obstacles in sharing relevant information and coordinating actions with regional and international counterparts. In the globalized world of finance, addressing cross-border financial crimes requires seamless cooperation. The structural deficiencies observed suggest potential gaps in communication channels, legal frameworks, or mechanisms for sharing relevant data. To overcome these challenges, Pakistan prioritized the enhancement and strengthening of its international cooperation mechanisms. This involves the consolidation of legal frameworks to foster improved diplomatic ties, facilitate information exchange, and actively participate in regional and international initiatives aimed at combating financial crimes (Shah et al., 2023).

FATF Recommendations to Pakistan

The FATF, an intergovernmental organization had placed Pakistan on its "gray list" due to various concerns regarding the CTF/AML measures. The FATF regularly updates its evaluations and recommendations, so it's important to check the latest reports or FATF publications for the most current information. Some of the most important areas where Pakistan was required to take due action included:

Strengthening AML/CFT Laws and Regulations

Enforcing and implementing comprehensive legal frameworks to address CTF/AML. Ensuring the criminalization of terrorist financing and money laundering activities.

Enhancing Regulatory Framework

Strengthening supervisory and regulatory measures for financial institutions, including

banks, corporate, and non-banking financial institutions, to ensure effective execution of AML/CFT controls.

Customer Due Diligence (CDD)

Improving customer due diligence procedures to ensure accurate verification and identification of customers. Moreover, implementing risk-based approaches for monitoring customers and higher-risk transactions.

Suspicious Transaction Reporting

Enhancing and strengthening the reporting of several suspicious and fishy transactions to the financial intelligence unit (FIU) for investigation.

International Cooperation

The FATF recommended strengthening cooperation with regional and international counterparts and other jurisdictions in prosecuting and investigating cases related to terror financing and money laundering.

Targeted Financial Sanctions

The international regimes also suggested Pakistan implement targeted financial sanctions against entities and individuals associated with militancy and terrorism, including freezing their assets.

National Coordination and Policy Coherence

Establishment of and maintaining a national coordinating mechanism or body that facilitates effective coordination and cooperation among various authorities involved in AML/CFT efforts. Ensuring that strategies and policies are consistent and coherent across different government agencies.

Non-Profit Organizations (NPOs)

Executing measures to mitigate the risk of exploitation of non-profit organizations for

terror financing and money laundering. Ensuring effective regulation and supervision of NPOs to prevent misuse of financial assets for illicit purposes.

Financial Intelligence Units (FIUs)

Strengthening the independence and capacity of the Financial Intelligence Units (FIUs) to analyze, receive, and disseminate suspicious transaction reports (STRs) effectively. Enhancing the information-sharing and cooperative mechanisms between the other relevant authorities and FIUs.

Technology and Innovation

Adapting AML/CFT measures to address several emerging new risks associated with scientific and technological advancements, such as cryptocurrencies, virtual assets, and online financial services. Ensuring that financial regulations keep pace with technological and scientific developments to prevent illicit financial activities facilitated by new technologies.

Sanctions Compliance

Ensuring compliance with regional and international sanctions regimes to prevent the proliferation of weapons of mass destruction (WMDs) and other illicit activities. Implementing effective mechanisms to freeze and identify the assets of entities and individuals subject to sanctions (Sultan et al., 2023).

Obstacles faced by Pakistan in Implementing FATF Challenges

Pakistan has also faced several challenges in implementing the FATF recommendations. These challenges have contributed to Pakistan's positioning on the FATF's "gray list" due to concerns regarding combating the CTF/AML measures. Some of the obstacles faced by Pakistan in this process include:

Legal Framework and Enforcement

Pakistan faced several legislative challenges in having an effective and comprehensive legal framework for terror financing and addressing money laundering. Pakistan needed to enforce and enact laws that comply with international financial standards.

Capacity and Resources

Pakistan faced challenges in building and enhancing the capacity of its financial and executive institutions responsible for AML/CFT enforcement. This includes law enforcement agencies, financial intelligence units, and regulatory bodies.

Political Will and Coordination

Achieving political will and consensus to effectively enforce and implement AML/CFT measures was a challenge for Pakistan. Coordination among different stakeholders and government agencies was essential, and achieving this political will across national political parties and coordination was a hurdle.

Risk-Based Approach

Adapting a risk-based approach to AML/CFT required a comprehensive understanding of risks associated with different entities and sectors. First developing and later implementing risk-based policies was a challenge for Pakistan.

Monitoring and Supervision

Ensuring effective monitoring and supervision of financial institutions, including banks, corporate sectors, and non-banking financial institutions, to prevent misuse for illicit purposes was a challenge for Pakistan.

Non-Profit Organizations (NPOs) and Informal Economy

Regulating and monitoring the informal economy and non-profit organizations to prevent misuse of terrorist financing was challenging. Additionally, addressing issues related to the non-documentation of the

economy, which may be susceptible to terror financing and money laundering, had posed difficulties.

Geopolitical Considerations

Geopolitical dynamics and political considerations may influence the implementation and assessment of AML/CFT measures. Balancing international expectations with national interests was a complex task.

Technological Challenges

Addressing newly emerging risks associated with virtual assets, online financial services, and cryptocurrencies has posed challenges in terms of supervisory measures and adopting regulations (Shah, 2023).

Criticism of the FATF Process

The FATF like any other regional and international regime is not exempt from criticism and its evaluation process has faced criticism from various quarters. Some of the most common criticisms include:

Lack of Consistency

Critics argue that there is a lack of continuity in the application of FATF standards across countries. The critics' perception is that financial evaluations might not be uniformly conducted, leading to disparities in outcomes at the end of its verdict.

Subjectivity and Interpretation

The interpretation and understanding of AML/CFT standards can be subjective, and critics argue that this subjectivity may result in different decisions and evaluations for similar situations.

Geopolitical Considerations

Some observers and countries suggest that geopolitical and strategic considerations may influence the evaluation process, leading to

questions about the impartiality and fairness of assessments.

Rigidity in Standards

There have been several criticisms that FATF standards may be overly prescriptive and not take into account the diverse legal and economic structures of the member countries. This rigidity and inflexible standards can make it challenging for some of the countries to fully comply.

Frequency of Standard Changes

The FATF periodically updates its standards, and does not remain consistent. Subsequently, some countries find it challenging to keep up with frequent changes in the standards. This can be particularly burdensome for developing countries with limited resources.

Limited Consultation Opportunities

While there is a consultation and deliberation process during the evaluation, some developing countries may feel that their perspectives are not adequately heard or given due weightage. Hence, the critics argue that the consultation process could be more inclusive.

Impact on Financial Inclusion

Stricter AML/CFT regulations may inadvertently impact financial inclusion by making it more difficult for certain entities and groups operating in the country, particularly those in marginalized and vulnerable communities, to access formal financial services.

Public Reporting Challenges

While FATF also publishes mutual evaluation reports, there have been numerous criticisms from every corner about the level of detail in these financial reports. Some argue that specific details of recommendations and findings are not always disclosed to the affected states, affecting transparency.

Enforcement vs. Capacity Building

Critics also argue that the focus on enforcement measures of FATF recommendations may not be balanced with efforts to build the capacity of developing countries to implement effective AML/CFT measures.

Unintended Consequences

Stricter AML/CFT measures and endorsements may lead to unintended consequences, such as causing financial exclusion or pushing illicit activities further underground or without significantly impacting terror financing and money laundering.

Impact on Sovereignty

Some countries further express concerns about the perceived encroachment on their national sovereignty, arguing that international financial standards may not always align with national economic and legal structures (Gilmour & Hicks, 2023).

Successes and Lessons Learned for Pakistan

While Pakistan has faced several challenges in implementing FATF endorsements, it has also made progress in various areas. Here are some successes and lessons learned for Pakistan in the context of its efforts to AML/CFT:

Successes

Legislative Reforms

Pakistan has made several legislative reforms to strengthen its legal framework. This includes enacting laws that criminalize terrorist financing and money laundering activities.

National Action Plan (NAP)

Pakistan has developed and simultaneously implemented a National Action Plan (NAP) to address AML/CFT concerns. The NAP outlines

specific measures to enhance compliance with FATF recommendations.

Enhanced Financial Supervision

There has been progress in enhancing the regulation and supervision of financial institutions, including banks, corporate sectors, and non-banking financial institutions. This is crucial for ensuring the effective execution of AML/CFT controls.

International Cooperation

Pakistan has engaged in regional and international cooperation to address cross-border AML/CFT challenges. The sharing of information and collaborative efforts with other jurisdictions contribute to a more effective and fruitful global response (Hussain, 2022).

Risk-Based Approach

There have been efforts from Pakistan to adopt a risk-based approach in AML/CFT measures, allowing resources to be directed more efficiently toward areas with higher risks of AML/CFT.

Improved Financial Intelligence Unit (FIU)

Pakistan has taken several steps to strengthen its Financial Intelligence Unit (FIU), enhancing its capacity to receive, analyze, and disseminate information related to suspicious national transactions.

Lessons Learned

Continuous Capacity Building

Ongoing capacity building for relevant institutions, including financial regulators, law enforcement agencies, and the FIU is crucial. This ensures that these entities and institutions have the resources and knowledge to effectively implement AML/CFT measures.

Enhanced Coordination

Improved national coordination among

various government and non-governmental agencies is essential. Ensuring a unified and coherent approach to AML/CFT measures helps address institutional challenges related to implementation.

Regular Risk Assessments

Regularly conducting comprehensive risk assessments is key to identifying and later addressing evolving risks associated with terror financing and money laundering. This informs the development of targeted measures.

Engagement with Stakeholders

Engaging with different stakeholders, including the civil society and private sector, is important. Their input can contribute to the development of practical and effective AML/CFT measures (Gul, 2018).

Public Awareness and Education

Promoting education and public awareness about the risks of terror financing and money laundering is crucial. This includes educating individuals, businesses, and other national entities about their roles and responsibilities.

Flexibility in Regulatory Framework

Building flexibility and eradicating obsolete mechanisms in the regulatory framework allows for adaptability to emerging risks and technological advancements. This is especially important in addressing challenges posed by cryptocurrencies and virtual assets.

Timely Implementation of Action Plans

Timely implementation and execution of action plans is essential. Delays in implementing necessary reforms such as red-tapism can lead to increased challenges and scrutiny in meeting FATF requirements.

Regular Review and Updates

Regularly reviewing and later updating AML/CFT procedures and policies ensures

that they remain effective and aligned with evolving global financial standards.

By recognizing aforesaid successes and learning from challenges, Pakistan can work toward full compliance with FATF recommendations by continuing to strengthen its AML/CFT measures. Ongoing collaboration with regional and international partners and a commitment to sustained improvements in financial structure will be key to achieving lasting success in these efforts (Ullah, 2022)

Conclusion

Pakistan's successful exit from the FATF "gray list" in October 2022 marks a cutting-edge and monumental achievement for the country, reflecting its incessant unwavering commitment to combating terror financing and money laundering. The culmination of this journey underscores a sustained and comprehensive effort by Pakistan to address the commendations set forth by the FATF. The voyage toward compliance involved legislative enhancements, multifaceted reforms, and institutional strengthening. The civil-military institution of Pakistan demonstrated significant leadership and political will in implementing a vigorous framework that aligns with regional and international financial standards. Legislative reforms were also enacted to criminalize and later penalize terror financing and money laundering activities, providing a solid legal and legislative foundation for combating financial crimes.

Important to this success was the adoption of a risk-based approach, allowing for a more effective allocation of national resources and

tailored interventions in the institutions prone to higher risks. Financial institutions underwent regulatory measures and rigorous supervision to ensure the implementation and execution of stringent AML/CFT controls. The enhanced capacity building of the Financial Intelligence Unit (FIU) played a pivotal role in improving the overall ability of the country to receive, analyze, and disseminate relevant information related to suspicious national transactions. Regional and international cooperation emerged as a cornerstone of Islamabad's strategy, with the country actively engaging with counterparts and stakeholders to coordinate, share, and investigate information, and align its efforts with global initiatives. By ensuring compliance with the UNSC resolutions and implementing targeted financial sanctions, Pakistan demonstrated its full commitment to international peace and security.

The successful exit from the FATF "gray list" not only signifies a triumph for the financial system of Pakistan but also holds broader implications for the international reputation and economic stability of the country. The concerted efforts made by Pakistan in implementing FATF's endorsements serve as a testament to its institutional resilience and the effectiveness of a collaborative, risk-based approach to AML/CFT measures. As Pakistan emerges from the shadows of scrutiny in October 2022, the lessons learned and institutional reforms implemented during this period are likely to contribute to a more sustainable and robust framework for financial security and integrity in the years to come.

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