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Pakistan and the Financial Action Task Force

Established in 1989, the Financial Action Task Force (FATF) has developed detailed criteria to assess the performance of all countries and jurisdictions in managing their financial dealings with the world outside their borders. Based on its criteria, the FATF made public 'grey' or 'black' lists, identifying those that did not meet its criteria. Pakistan, for a variety of reasons, was one of the targeted countries. In June 2018, it avoided being put on the 'black' list by agreeing to a 26-point action plan formulated by the government in place for an interim period to manage the general elections scheduled for 25 July 2018. This paper will elaborate how political considerations have seeped into the FATF's decision-making process and its mode of operation. It then goes on to discuss the impact this decision will have on Pakistan's economic future.

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The Financial Action Task Force Task and its Mode of Working

The Financial Action Task Force (FATF) was formed following a decision by the Group of Seven (G7) at its Summit held in Paris in 1989. The world's rich nations were concerned that

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unrecorded flow of funds out of their countries into the unregulated financial institutions located in dozens of jurisdictions, mostly in the Caribbean, were hurting their fiscal systems. In addition to the funds that were coming into the tax havens, significant amounts were believed to be financing criminal activities such as the drug trade between South and Central America and the United States (US). The rich G7 nations had concluded that there had to be a mechanism to bring these flows into the regulatory systems.

The FTAF was tasked to study money-laundering trends, and monitor legislative, financial and law enforcing activities at the national and international level. It was required to report compliance and issue recommendations and standards to combat money laundering. The mandate of the task force was expanded to include terrorist financing following the attacks on the US on 11 September 2001 (9/11). The use of foreign funds to aid terrorist activities was added to the FATF's mandate. Initially, it had 16 members. The membership increased to 37 by 2016. Saudi Arabia has been admitted as an associate member (see Annex 1).

In its first year of its operation, the task force issued a report containing 40 recommendations. After 9/11, the FATF adopted nine Special Recommendations on Terrorism Financing. The criteria for judging the performance of the countries and political jurisdictions covered essentially five items, each relating to the capacities of the governments whose performance was under scrutiny. The criteria included the following:

i. Implementation of relevant international conventions;

ii. Criminalisation of money laundering that would enable authorities to confiscate the proceeds of money laundering;

iii. Implementation of customer due diligence (for example, identity verification of account holders in financial institutions), record keeping, and reporting of suspicious transactions by financial institutions and designated non-financial businesses and profession;

iv. Establishment of a financial intelligence unit in each jurisdiction to receive and disseminate suspicious transactions: and

v. Cooperation, internationally, in investigating and prosecuting money laundering.

In February 2004, and updated five years later, the FATF published a reference document titled *Methodology for Assessing Compliance* with its 40 recommendations and nine special recommendations. In 2012, FATF codified its recommendations and interpretive notes into one document. The purpose behind all this work was to identify the countries and the jurisdictions that failed to meet these criteria. It was assumed - correctly it turned out – that the fact of being included in the list would have fairly serious consequences for the concerned countries and have them move towards compliance.

In 2000, the FATF issued a list of 15 jurisdictions of Non-Cooperative Countries and Territories, commonly called the 'black' list. Another eight countries were added to the list in 2001. The list included the countries that were considered to be uncooperative in the fight against money laundering. The combined list included 23 political entities – countries and jurisdictions (see Annex 2). The list was made up mostly of jurisdictions in the Caribbean. The list was not without controversy; for instance, the inclusion of the Cayman Island as non-cooperative was regarded by most financial experts as being harsh, particularly when the report itself had said that "it has been a leader in developing anti-money laundering programs throughout the Caribbean region."[2] The list is reviewed by the Task Force every year, with countries and jurisdictions moving in and out of it, depending on what had occurred in the year under review.

Politics in the Work of the FATF

As was the case with Pakistan, the drawing up of the list was not always free of politics. Some of the countries on the Task Force used the list to push some states to meet the strategic interests of some of the powerful members of the Task Force. A detailed analysis of the Task Force's findings published in the newspaper *Dawn* found enough reason to believe that there was a strong political reason for it. The authors of the story noted that the US is a major financier of the FATF and the current president of the Task Force is an Assistant Secretary from the US Department of the Treasury who heads the Office of Terrorist and Financial

[2] "Cayman Islands Tells FATF All Anti-Money Laundering Criteria Met", Caymannetnews 9 October 2000. https://www.tax-news.com/news/Cayman_Islands_Tells_FATF_All_AntiMoney_Laundering_Criteria_Met____972.html. Accessed on 12 July 2018.

Crimes.[3] This American Office has been putting pressure on Islamabad to stop the flow of foreign funds to the organisations it views with suspicion. The authors wrote that the "bottom line is that [the] FATF's grey listing of Pakistan should not be looked at in isolation but placed in the larger picture of US-Pakistan relations that have had many ups and downs."[4] In an editorial, the newspaper suggested that the timing of the FATF's decision "will burnish the impression that the global financial watchdog is responding to geopolitical considerations of other powers, notably those of the US and India, by putting an interim government in the impossible position of answering for policy matters that it does not have a mandate for."[5] The newspaper was underscoring the point that Islamabad, at the time the decision was announced, was being administered by an interim government that took office under the Constitution when the national assembly was dissolved and the country was preparing to hold general elections. It could not act decisively to meet the FATF concerns.

For the first time, the government, albeit an interim one, made a commitment to proceed against a number of organisations that were working with the avowed aim of placing Pakistan and Afghanistan under an Islamic political, social and economic order. The plan included curbing access to finance to the Lashkar-e-Taiba (LeT), Jammatud Dawa (JD), Falah-i-Insaniat, Jaishe-Muhammad (JM), the Haqqani network and the Afghan Taliban. As discussed later in this paper, some of these entities had already been identified as terrorist organisations by the United Nations and the US. However, not unlike the Egypt-based Muslim Brotherhood, the LeT was operating JD as a social welfare organization, focusing on promoting social welfare to the underprivileged and underserved segments of the population that the weak Pakistani state was not able to reach. However, some of these organisations were seen to be closely aligned to the country's mainstream political organisations, for example, the JM was the virtual political arm of former president Nawaz Sharif's Pakistan Muslim League-Nawaz.

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3 Usman Hayat and Shahid Karim, "Pakistan on FATF's grey list: What, why and why now?" *Dawn*, June 30, 2018.

4 Ibid.

5 "FATF's unwelcome action", *Dawn*, 29 June 2018, p. 7.

The FATF Action against Pakistan

Pakistan has been in and out of the FATF lists for more than a decade. It was there in 2008, was able to leave it a few months later, was back on it again in 2015, was taken off once again but came back on the 'grey' list in June 2018. The FATF, in its meeting in Paris in early 2018, warned Islamabad that it would put the country on the 'grey' list – even, possibly the 'black' list – if it did not take steps to meet the Task Force's concerns. The FATF's public statement issued on 29 June 2018 recognised that "Pakistan has made a high-level political commitment to "strengthen its anti- money laundering (AML) and counter-terrorist financing (CFT) deficiencies". The reference was to the high level National Security Committee that met on 9 June 2018 in Islamabad and approved an action plan that was submitted to the FATF. Basing its conclusions on the plan of action approved by Islamabad, the Task Force identified the following ten actions Pakistan needed to exit from the list. Pakistan is required to implement the plan of action in 15 months:

- Identify terrorism financing risks, assess their impact and supervise the plans devised to address them.

- Take remedial actions and sanctions in cases of money-laundering and financing terrorism violations.

- Empower, coordinate and identify and enforcement action against illegal money or value-transfer services.

- Identify cash couriers and enforce controls on illicit movement of currency and determine the risks of cash couriers being used for financing terrorism.

- Improve inter-agency coordination including those operating at the Federal and Provincial levels for combating terrorism financing risks.

- Identify and investigate financing of terrorism and prosecute designated persons and entities.

- Undertake finance terrorism prosecutions and enhance the capacity and support for prosecutors and judiciary.

- Ensure effective implementation of targeted and financial sanctions against all designated terrorists.

- Enforce actions against financing of terrorism including administrative and criminal penalties.

- Move against the facilities and services owned or controlled by designated persons aimed at depriving them of resources.

The FATF's move was a serious jolt for Pakistan. As discussed below, such an action taken to its extreme, could mean putting the country on the 'black' list. That could have serious economic consequences. The country now has 15 months to implement an action plan it had formulated and the task force had accepted. Entry and exit from the 'grey' list is a continuing process. There are several examples of nations that have been able to leave the list. These include Pakistan as well as Panama, Kenya and Nigeria.

Background to the FATF's Action

The FATF's concerns were focused on the following areas. The first was foreign financing of a number of organisations in the country that were allegedly involved in both domestic and international terrorist activities. India, a member of the FATF, was especially concerned with the activities of the LeT that had been designated as a terrorist organisation by both the UN and the US. The Indians had provided evidence to the government in Pakistan linking the LeT to the November 2008 attack on Mumbai, the financial centre of the country, by a group of heavily armed men who took a boat from Pakistan, penetrated the Indian sea defenses, landed at Mumbai's seafront, took possession of some buildings, including a five-star hotel, and killed more than 160 persons. The Indian counteraction was slow in coming; when it did, a commando force killed all but one intruder. The one captured, put on trial and eventually executed, gave detailed account of the planning by the LeT in Pakistan that resulted in the attack. However, the authorities in Pakistan did not take action against the people identified as the perpetrators of the attack. Hafiz Muhammad Saeed, the head of the LeT, moved freely around the country even though the Americans had announced that his arrest and eventual surrender to the US would be rewarded with a large payout. The LeT was also active in the Muslim majority state of Jammu and Kashmir. Pakistan, to India's great disappointment and anger, had not moved against these individuals. The Mumbai attack put on hold the peace agreement the government of General Pervez Musharraf had almost concluded with India.[6]

The second area of concern was the flow of finance to another terrorist group, the Haqqanis, who were operating against the US and official Afghan forces in Afghanistan. Washington had been putting pressure on Islamabad to move against the Haqqanis. It urged that Pakistan should remove their sanctuaries in the Tribal Belt from which they were launching attacks on Afghanistan. There was also the demand that the authorities in Pakistan should block the flow of funds that came in from private individuals who financed the Haqqanis as well as some other terrorist organisations. Most of these organisations were involved in promoting radical Islam in Pakistan and Afghanistan, possibly also in China and the Indian part of the disputed state of Jammu and Kashmir. A good part of private funding for these organisations was coming from the Middle East through the informal *hundi* and *hawala*[7] channels. This is a complicating factor in which Pakistan is one of several players. The millions of people who have gone to the Middle East to provide labour in these oil-rich countries have come under the influence of radical preachers working in the mosques they attend. While most of the savings of these workers go back to their families as remittances, some also flow into the coffers of the radical Islamic organisations. Not only are these organisations operating in Pakistan; some are also in Afghanistan, and even in India.

India and the US joined forces with the FATF and mobilised support from the Tasks Force's European members to exert pressure on Pakistan. The delegation from Pakistan came well prepared to handle the Task Force's concerns and its most assertive members. Pakistan's Interim Finance Minister Shamshad Akhtar attended the FATF Plenary in Paris in June 2018 that looked at the plan of action developed by the Pakistan government. However, she was not able to save her country from being placed on the 'grey' list.

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6 For the details of the agreement see Khurshid Kasuri, *Neither Hawk nor a Duck; An Insider's Account of Pakistan's Foreign Relations,* Karachi, Oxford University Press, 2016.

7 The *hundi* and *hawala* are informal or traditional systems in the Middle East and South Asia for transferring money through local agents.

On 27 June 2018, the FATF placed Pakistan on its list of "jurisdictions with strategic deficiencies," known as the 'grey' list. The Task Force's reasoning was Pakistan's "structural deficiencies" in the AML and the CFT. Pakistan joined the list of countries that included Ethiopia, Serbia, Sri Lanka, Syria, Trinidad and Tobago, Tunisia and Yemen. This list had one thing in common. With one exception – Trinidad and Tobago – all the countries on the 'grey' list were faced with serious domestic conflict. There were raging civil wars in Libya, Syria and Yemen. In several countries, domestic conflicts had taken a heavy human toll. At least from that perspective, Pakistan did not quite belong to this group of countries.

There are institutions other than the FATF that rank countries according to financial or other type of support for terrorism. For instance, the Basel Institute on Governance that describes itself as "an independent not-for-profit competence center" associated with Basel University in 2017 ranked Pakistan 46 out of more than 100 countries. The Global Institute for Economics and Peace, which also compiles what it calls a terrorism index, ranked Pakistan as the fifth-most affected country from terrorism, behind Iraq, Afghanistan, Nigeria and Syria.

Pakistani Reactions

One Pakistani reaction came from Ali Jehangir Siddique, the newly-installed Ambassador in Washington. In an interview with *Bloomberg TV*, he said that his government had chalked out a 15-month framework to get the country off the 'grey' list. Before coming to Washington, Siddique had worked for 10 months in the Prime Minister's Office (PMO). At that time, Shahid Khaqan Abbasi was the Prime Minister, a position he left following the dissolution of the national assembly after it had completed its five-year term. One of the tasks Siddique handled in the PMO was to prepare the plan of actions submitted to the FATF. Elections to the new assembly are scheduled to be held on 25 July 2018. One of the important tasks for the new government, that takes office after the elections, would be to take care of the situation created by the FATF's designation of Pakistan as a 'grey' list country.

However, some prominent members of the opposition were not pleased that Islamabad had informed the FATF that it would implement the programme it had formulated over a period of 15 months. Mian Raza Rabbani, a prominent member of the Pakistan People's Party who had served as the Chairman of the Senate for a number of years, was unhappy that the Senate, which was still in session after the dissolution of the National Assembly, had not been consulted by the interim administration that was in office preparing the July elections. "Such a major step which has financial, political repercussions should have been left to the new Parliament",[8] he said in a statement issued to the media.

The English-language newspapers were concerned that Pakistan may not take the actions it had promised the FATF. In an editorial, *Dawn*, the most widely circulated paper in Pakistan, took a serious note of the situation created by the FATF's action, "There is little point in passing the laws and regulatory measures required by [the] FATF to shield the country's financial system from terror financing if groups and individuals known to have been involved in terrorist activity, and designated by the UN as such, are free to roam, organize, solicit funding and get involved in electoral politics."[9] The reference, of course, was to the LeT.

The Chinese reaction to the FATF decision dwelt on what it saw as the sacrifices Pakistan had made to combat terrorism. "We will not comment on the decision of the task force", said Lu Kang, the Chinese foreign ministry spokesman. China is a member of the Task Force. "But we understand Pakistan has made enormous efforts for counter-terrorism and made great sacrifices...We always believe that Pakistan government and people have made enormous efforts to and sacrifice on counter-terrorism, and the international community should fully recognize this."[10] On the day the Task Force announced its decision, Beijing announced a US$1 billion (S$1.36 billion) loan to Pakistan to strengthen its balance of payments situation.

While the official position in Pakistan was positive for having avoided the 'black' list, both the US and India felt vindicated by the FATF's decision. The Indians were pleased. "India welcomes the decision of the Federal Action Task Force to place Pakistan in its Compliance Document ('grey' list) for ICRG monitoring",[11] said the country's ministry of external affairs, in a statement issued soon after the decision was announced by the Paris-based organisation.

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8 *The News*, "Govt overstepped mandate by agreeing to FATF plan: Raza Rabbani", 2 July 2018.

9 *Dawn*, editorial, "FSTF's unwelcome action", 29 June 2018, p. 7.

10 *The Times of India*, "Pakistan on FATF 'grey list': China refuses comment; praises Islamabad's counter-terror effort, 29 June 2018.

11 *India Today*, "India welcomes FATF's move to place Pakistan in 'grey list' for failing to check terrorism", 30 June 2018.

Conclusion

If Pakistan is not able to get off the FATF's 'grey' list and is moved on to the 'black' list, there will be serious consequences for the country. The FATF's action comes at a time when Islamabad is faced with a serious external finance situation. It has used at least a third of its foreign exchange reserves in trying to maintain the value of the rupee. This was an ill-advised policy that was compounding the pressure on foreign exchange reserves. By keeping the value of the domestic currency high, Pakistan was losing out to its competitors in foreign markets. Some corrections have been made to this policy. Over the last four months, the value of the Pakistan Rupee has declined by 15 per cent. However, the FATF's actions will make it expensive for the country to obtain non-official foreign funds. With the hardening of the US' approach towards Pakistan, the country's access to Official Development Assistance is now severely limited. One unintended consequence of the FATF's move might be to push Pakistan firmly into the Chinese orbit. As indicated above, Beijing has already come in with a billion dollars of budgetary support for Pakistan.

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Annex 1

Members of the Financial Action Task Force Task

1. Argentina
2. Australia
3. Austria
4. Belgium
5. Brazil
6. Canada
7. China
8. Denmark
9. European Commission
10. Finland
11. France
12. Germany
13. Greece
14. Gulf Cooperation
15. Hong Kong, China
16. Iceland
17. India
18. Ireland
19. Italy
20. Japan
21. South Korea
22. Luxemburg
23. Malaysia
24. Mexico
25. Netherlands
26. New Zealand
27. Norway
28. Portugal
29. Russian Federation
30. Singapore
31. South Africa
32. Spain
33. Sweden
34. Switzerland
35. Turkey
36. United Kingdom
37. United States

Annex 2

Countries in the 'Black' List of the Financial Action Task Force Task

1. Bahamas
2. Cayman Islands
3. Cook Islands
4. Egypt
5. Dominica
6. Grenada
7. Guatemala
8. Hungary
9. Myanmar
10. Nigeria
11. Ukraine
12. Indonesia
13. Israel
14. Lebanon
15. Liechtenstein
16. Marshall Islands
17. Nauru
18. Niue
19. Panama
20. Philippines
21. Russian Federation
22. Saint Kits and Nevis
23. Saint Vincent and the Grenadines