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Issue Brief

FATF as an Instrument of CFT Compliance in Pakistan

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S*ummary*

Pakistan's desperation to keep itself off the list of defaulting countries maintained by the Financial Action Task Force (FATF) underlines the increasing effectiveness of the organisation, which has become the spearhead against global efforts combating the financing of terrorism (CFT). Pakistan will continue to remain under pressure to undertake urgent measures to improve the effectiveness of its CFT record. Further, its ability to merely employ symbolic measures as a substitute for combating terrorism is increasingly going to become a challenge in future.

Pakistan finds itself in the eye of yet another storm. It employed every diplomatic and fire-fighting trick in the book to keep itself off the list of defaulting countries maintained by the Financial Action Task Force (FATF) at the FATF Plenary held in February 2018. Pakistan's desperation underlines the increasing effectiveness of the organisation, which has become the spearhead against global efforts combating the financing of terrorism (CFT). This brief will analyse the basis for FATF's growing effectiveness in the fight against terrorist finance and how this could enhance Pakistan's CFT compliance over time.

FATF: Key Roles

The FATF has been at the forefront of international efforts to fight money laundering and CFT. Its efforts have been in conjunction with relevant resolutions of the United Nations Security Council (UNSC), especially in the aftermath of 9/11. FATF is an inter-governmental body set up in 1989, with an aim to "set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system."¹

It has 37 members, including two institutions, the European Commission and the Gulf Co-operation Council. In addition, it has two observers and nine associate members, which are primarily regional organisations. There are also a number of observer organisations, which either have a related area of work that deals with enforcement like Europol, financial institutions like the International Monetary Fund (IMF) and UN bodies or groups linked with counter terrorism or money laundering.² The FATF functions as an independent body guiding policy, with its president selected by the plenary for a one year period.

Over a period of time, since its inception, the FATF has gained perceptible credibility as a professional organisation, which has succeeded in not only increasing awareness regarding the challenges being faced by the global financial system, but also human security issues like terrorism. It has gained considerable influence over the regulatory framework that deals with financial transactions, in an attempt to make it less liable to exploitation by both profiteers and terrorists.

FATF Effectiveness

The FATF has gained in importance, despite the fact that it is merely a task force, which is funded by its member countries and has a mandate extendable for specific

¹ "Who Are We", *Financial Action Task Force*, <http://www.fatf-gafi.org/about/>, accessed on February 19, 2018.

² "Members and Observers", *Financial Action Task Force*, <http://www.fatf-gafi.org/about/membersandobservers/>, accessed on February 22, 2018.

durations. This relevance emerges from the manner in which it has evolved to gain credibility and influence given the wide acceptance of its recommendations, close linkages with institutions that extend finance to countries and the impact that its risk assessment has on financial decision making. The effectiveness of the FATF emerges from a number of factors. First, the organisation does not grant overriding voting rights to any of its members. There is no veto power that any country or organisation enjoys. The FATF follows a consensus-based model of decision making within the plenary, the highest decision-making body that meets thrice a year.

In contrast, the United Nations (UN) is constrained by this provision. This has been seen wherein China has effectively blocked the listing of Masood Azhar, the head of the Jaish-e-Mohammad (JeM), a group which is already listed as a terrorist organisation by the United Nations Security Council (UNSC). Despite its resolutions that have become the basis for listing terrorist groups and individuals, and that too under Chapter VII, there is little that world powers have been able to do to countries like Pakistan, which have clearly been in violation of UNSC resolutions.

Second, the FATF has adopted a policy of “naming and shaming.” While the UN has occasionally resorted to the same, it is not necessarily implemented as a policy for judging the effectiveness of counter terrorism resolutions in relation to specific countries. The policy of the FATF has a corrective underlying principle to this approach. The fact that a country can be placed on a list and then removed thereafter on receipt of assurance from the highest political authority, along with a judgment on the progress made to implement the guidelines, has ensured an improvement in the overall CFT and AML standards.

Third, countries can initiate economic sanctions against target nations within the UN. However, besides the veto constraint, the inability of the UN to enforce it remains an enduring limitation that has rarely witnessed desirable results. Iran is an exception to this record vis-a-vis its contentious nuclear programme. However, even in this case, it was the threat of being cut off from the US financial system if they did business with Iran that forced action on part of most countries that traded with Iran.

In contrast, the basis of listing countries by the FATF is on the basis of their compliance with transparent guidelines and their effective implementation. In addition, the incentive of being removed from the list on the basis of even a gradual response, has led to desired results. It is only in case of the refusal of a government to implement guidelines and provide an assurance to undertake corrective measures that the FATF recommends strong measures.

Fourth, the actions of the UN often tend to get deeply influenced by geopolitical considerations, rather than technical parameters, which are based on objective and professional analysis, as in the case of the FATF. The potential and possibility of major powers wielding influence over other countries within the FATF though cannot

be wished away. The support for Pakistan that came from “friends” both within the UNSC and more recently in the FATF is an example of the same.³

Finally, the FATF gains credibility by its ability to hurt a country where it hurts the most, its economic well-being. The body achieves this, as was the case with Pakistan until 2015, neither by applying or recommending sanctions. It does so by indicating to the financial world that a country is in violation of CFT and anti-money laundering (AML) guidelines. For most correspondent banks, financial institutions, rating agencies and other countries, this raises a red flag that can only be ignored at their peril. It is for this reason that leaders and bureaucrats from Pakistan have been scurrying from one world capital to another to lobby for blocking its inclusion on the FATF list of countries in violation of fundamental guidelines. An illustration of the same is best made through concerns raised within Pakistan and empirical evidence that at least partly provides indicators in this direction.

FATF Evaluation and Compliance: The Case of Pakistan

The trajectory of the FATF’s effectiveness has seen it evolve from merely emphasising on the framing of laws to encouraging its implementation and finally with the fourth round of mutual evaluations in 2012, to assessing the effectiveness of its implementation.⁴ This can be better understood by relating it to the focus and implementation of the process.

There are two elements to gauge the effectiveness of guidelines that govern global standards to safeguard the financial system and fight terrorism and money laundering. First, a technical evaluation assesses compliance with associated elements of all 40 recommendations. Thereafter, each country is evaluated on effectiveness parameters, based on 11 areas of implementation. These include measures that are particularly relevant for a country like Pakistan that has been accused of selectively targeting terrorists. An elaboration of two of these parameters gives an idea of how the effectiveness of existing guidelines is being ensured.

First, *Terrorist financing investigation and prosecution* ensures that “terrorist financing offenses and activities are investigated and persons who finance terrorism are prosecuted and subject to effective, proportionate and dissuasive sanctions.”⁵ This at the least can be employed to keep a tab on the prosecution of UNSC declared

³ There were clear indicators of China leading the support for Pakistan within the FATF during the February 2018 plenary. Pakistan Foreign Minister Khawaja Asif’s tweet thanking “friends” for not allowing consensus to be built is a case in point. This too did not yield the necessary results for Pakistan, as China backed out at the last minute, despite its steadfast stand in the past. See Khurram Husain, “Pakistan set to be placed on FATF’s grey list in June”, *Dawn*, February 24, 2018, <https://www.dawn.com/news/1391342>, accessed on February 25, 2018.

⁴ FATF Annual Report 2015-16, *FATF*, Paris, 2017, <http://www.fatf-gafi.org/media/fatf/documents/reports/FATF-annual-report-2015-2016.pdf>, accessed on February 20, 2018, p. 31.

⁵ *Ibid*, p. 32.

terrorists like Hafiz Saeed and his organisation, an action that Pakistan continues to shy away from. This was also indicated by the FATF in its follow-up reporting and has become one of the major factors for Pakistan being pressurised to take requisite action against terrorists operating from its soil.

Second, *terrorist financing preventive measures & financial sanctions* require that “terrorists, terrorist organisations and terrorist financiers are prevented from raising, moving and using funds, and from abusing the non-profit sector.”⁶ This yet again has Pakistan squarely in its crosshairs. The use of Jamaat-ud-Dawa (JuD) and Falah-e-Insaniyat Foundation (FIF) by Pakistan to not only collect, move and distribute funds but also undertake terrorist acts — despite these so-called charities being on the UNSC list of terrorist organisations, only reinforces its gross violation of the guideline.

The FATF and its subsidiary organisations like the Asia Policy Group (APG), a regional body with members from the Asia-Pacific region, undertake the evaluation of countries. Despite the fact that Pakistan was removed from the list of countries that had strategic deficiencies in its AML/CFT regime in 2015, the deficiencies were subject to an ongoing compliance process. A specific issue highlighted was Pakistan’s inadequate compliance of UNSC Resolution 1267, which called for action against terrorism in Afghanistan in the immediate aftermath of 9/11.⁷ This was subsequently enlarged to include groups like the Lashkar-e-Taiba (LeT) and JuD. Despite this relief provided to Pakistan, a report of the FATF of February 13, 2015 indicated the following:

Some RRG members are concerned that Pakistan needs to take further actions to ensure more freezing and enforcement of prohibitions of financial transactions with particular terrorist organisations openly operating in Pakistan. The concerns mainly relate to the terrorist groups of Lashkar-e-Tayyiba (LeT) (and its co-listed entities, Falah-e-Insaniyat Foundation (FIF), and Jamaat-ud-Dawa (JuD)). ... Despite all these efforts, it is not clear that the freeze orders are being fully implemented given that the designated entities JuD and FIF appear to continue to operate openly in Pakistan.⁸

The impact of the revised procedures of the FATF became evident when Pakistan was not only scrutinised for the laws that it framed, but also for its implementation. An illustration of the same came to the fore when the convictions under the law were scrutinised by the FATF. It emerged that all the convicted terrorists belonged only to

⁶ Ibid.

⁷ “Resolution 1267 (1999)”, United Nations Security Council, October 15, 1999, http://www.un.org/ga/search/view_doc.asp?symbol=S/RES/1267%281999%29, accessed on February 20, 2018.

⁸ The Financial Action Task Force, International Co-operation Review Group, February 13, 2015, [https://www.fic.na/uploads/FATF/FATF-2015/FATF-ICRG\(2015\)4-ENG.pdf](https://www.fic.na/uploads/FATF/FATF-2015/FATF-ICRG(2015)4-ENG.pdf), accessed on December 02, 2016.

the JeM.⁹ Further, the cases for which they were arrested related to domestic terrorism within Pakistan and not against India, which has been the group’s primary target. Similarly, the absence of cases against groups like the Haqqani Network and LeT, despite these being proscribed by the UNSC, was in tune with Pakistan’s past approach of selectively targeting terrorist organisations and allowing others to not only operate with impunity, but also with state support.

The US proposal introduced in the February 2018 session of the FAFT in conjunction with United Kingdom, Germany and France, to seek Pakistan’s reintroduction on the list of countries with serious shortcomings in their AML/CFT compliance, is thus based on a sustained assessment of measures undertaken to remove the same. Pakistan was earlier removed from the list in 2015 (after being placed on it in 2012) based on its improvement of the AML/CFT regime, though, on the premise that it will address issues identified as part of UNSC Resolution 1267. The reply of Chaudhury Nisar Khan, Minister for Interior and Narcotics, on the floor of the Punjab Senate in March 2015, reproduced below, clearly indicates the refusal of the state within Pakistan to comply with UNSC resolutions and FATF requirements:

“(a) Any organization proscribed under S 11 B of the Anti Terrorism Act 1997 is prohibited from any and all activities including charity work under a different name.

(b)	Banned Organisation	Suspect Charity	Status
1	Jaish-e-Mohammad	Khuddamul Islam Jamiatul Furqan Al-Akhtar Trust Al-Rashid Trust Al-Rehmat Trust Al-Anfaal Trust	Banned Banned UNSCR listed UNSCR listed US listed US listed
2	Lashkar-e-Taiba	JamaatudDawa Falah-e-Insaniyat	UNSCR listed UNSCR listed

(c) UNSCR has listed Jamaat ud Dawa as an alias of Lashkar-e-Taiba. Supporting evidence has not been shared with Pakistan to establish such

⁹ Ibid.

connection. Jamaat ud Dawa has been on observation orders under S.11 D of the Anti Terrorism Act since 15 November 2003. Their activities are mentioned by law enforcement agencies. If report of activity that fulfills requirements of S.11 B of the ATA is presented, the organisation shall be proscribed.

(d) Currently JuD is placed under observation under S.11 D vide SRO no 1040(1)/2003 E. No. 7/26/2001-Pol.1(3)(iv) dated 15 November 2003 and mentioned in all provisions for any suspect activity. Between 2008 and 2010 the offices were closed, however relief was given by the Lahore High Court in WP 19705/2002. Presently, Jamaat ud Dawa is engaged in charity and social work, operating hospitals, clinics, schools, ambulance service and religious institutions.”¹⁰

FATF Listing and Pakistan’s Concerns

Ahsan Iqbal, Pakistan’s Interior Minister speaking in the Senate in February 2018 voiced the fear that being placed on the list again at the FATF Plenary could make it “harder for foreign investors and companies to do business in the country.”¹¹ *The Dawn* suggested that the possible implications of being placed on the list seemed to have already affected the stocks, with the “KSE-100 Index plunging 411 points to close at 42,942 on Thursday [February 15], as a bearish spell continued to prevail at the Pakistan Stock Exchange.”¹²

Besides these indicators, an assessment of the period from 2012 till 2015 also provides useful data points as Pakistan was placed on a similar list in the past. Amongst other factors, the credit rating of a country is the basis for assessing its financial credibility. Moody’s credit rating for Pakistan was downgraded to ‘junk’ category during the three years that it was on the FATF listing.¹³ Pakistan enjoyed better ratings both prior to and after the listing, further reinforcing the impact of the action. While this may be influenced by more factors than one, yet, the listing by the FATF does provide a useful indicator.

The impact of such a rating is elaborated upon by a World Bank and South Africa Reserve Bank paper which is based on research data collected from 20 countries for the period from 1998 till 2015. The study suggests that “a downgrade of sovereign credit ratings to sub-investment or ‘junk’ status has a negative effect on public

¹⁰ Question No. 57(Def.) Mr. Farhatullah Babar, March 25, 2015, *Senate Secretariat*, 117th Session, July 7, 2015.

¹¹ Nadir Guramani, “Pakistan on global lobbying campaign against placement on terror financing watchlist”, *Dawn*, February 18, 2018, <https://www.dawn.com/news/1389591>, accessed on February 20, 2018.

¹² Ibid.

¹³ See “Rating: Pakistan Credit Rating”, *countryeconomy.com*, <https://countryeconomy.com/ratings/pakistan>, accessed on February 21, 2018.

borrowing costs.”¹⁴ Further it could increase the Treasury bill rates by an average of 138 basis points.

Ali Khizar, head of research at Business Recorder, Pakistan, reinforces this point. He argues that the first casualty of the listing could be Pakistan’s credit rating. This will adversely impact its ability to raise loans from major international financial institutions to service existing debt. This will become even more difficult as compared with the previous listing, given the adversarial relationship with the US and the latter’s influence in major financial institutions.¹⁵

Going Forward

The FATF statement at the end of the conference did not as yet include Pakistan on the list of countries subject to the compliance process. However, inputs from the conference suggest that a vote indeed took place and Pakistan will be placed on the list in June 2018.¹⁶ This is likely to ensure that Pakistan will remain under pressure to undertake urgent measures to improve the effectiveness of its CFT record. Further, its ability to merely employ symbolic measures as a substitute for combating terrorism is increasingly going to become a challenge in future.

A number of countries have been on the FATF list on account of procedural limitations or constraints on capacity. Pakistan however will again find itself identified as a state that has been complicit in the funding of terrorism, by its continued refusal to take necessary action against terrorist leaders and groups. The FATF listing will negate any pretensions of being a victim that Pakistan has employed to obfuscate its role in funding terrorism and employing it as state policy.

¹⁴ “Analysis: How do Credit Downgrades Affect Short-Term Government Borrowings”, *The World Bank*, August 17, 2016, <http://www.worldbank.org/en/news/feature/2016/08/17/analysis-how-do-credit-downgrades-affect-short-term-government-borrowing>, accessed on February 21, 2018.

¹⁵ Ali Khizar, “Credit rating will be the first casualty?”, *Business Recorder*, February 21, 2018, <https://fp.brecorder.com/2018/02/20180221345850/>, accessed on February 21, 2018.

¹⁶ Sushant Singh, “To put terror lens on Pakistan, US nudged Saudi, cut China deal”, *Indian Express*, February 25, 2018, <http://indianexpress.com/article/world/to-put-terror-lens-on-pakistan-us-nudged-saudi-cut-china-deal-5077044/>, accessed on February 25, 2018.

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