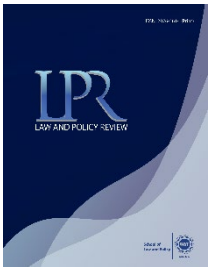
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Anti-Money Laundering (AML) Regime in Pakistan: Deficiencies and the Way Forward

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Abstract

The Financial Action Task Force (FATF) has placed Pakistan in the grey list for falling short of efforts to curb money laundering. Resultantly, Pakistan has been subject to increased monitoring regarding money laundering, terror financing and proliferation financing and encounters an enhanced follow-up. In the context of FAFT's placement of Pakistan in the grey list and the measures taken by the Pakistani government to tackle money laundering, this study examines the efficacy of the legal regime regarding Anti-Money Laundering (AML) practices in Pakistan. It analyses critically the legal framework of Pakistan concerning AML and evaluates the policies adopted to combat it. The study argues that despite the commendable efforts of successive Pakistani governments to control money laundering, effective execution and capacity building of concerned institutions can play an important role in strengthening the domestic mechanism that counters/ prevent money laundering.

Keywords: Anti-Money Laundering (AML), legal regime, Financial Action Task Force (FATF), money laundering, terror financing.

Introduction

The term Money laundering refers to the actions and processes of injecting money acquired through illegal means, criminal activities and unlawful gains into the mainstream economy (Jaffery & Mughal, 2020). The issues related to money laundering were highlighted at the international level during 1960s with reference to narcotics and illicit drug trading in South America. The avenues of the laundered money are broadened by weak fiscal compliance and lack of governance in developing countries, as well as due to un-organised business structures and ineffective mechanisms at the international level to address the related issues (Qureshi, 2017). The incident of 9/11 generated a new order to combat terrorist financing and money laundering. The hijackers of September 11 used local and foreign

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financial institutions to move and retreat the money. They used wire transfers, traveller's checks and cash withdrawal of foreign funds from other countries. The 9/11 plot cost Al-Qaeda $ 400,000 to $ 500,000 and the major portion of it was passed through the local banks in the United States of America (U.S Government Publishing Office, 2013).

The Financial Action Task Force (FATF), an intergovernmental organization established by G-7,[1] deals with anti-money laundering checks and controls at the international level. FATF has adopted a carrot and stick policy to ensure the implementation and compliance of its recommendations by the member states (FATF, n.d). Pakistan is among the countries that face the problems of financial crimes, corruption and terrorism financing. The Transparency International Corruption Index ranked Pakistan on 140th position, out of a total of 180 countries (Transparency International, 2021). Similarly, the World Governance Indicator placed Pakistan on the 21st position among a total of 100 countries. Pakistan was placed under increased monitoring, that is, on the grey list issued by FATF in 2018 for the deficiencies in action plans against money laundering. FATF has prepared two lists of countries, namely the black list and the grey list. The countries in the black list are non-cooperative countries. According to FATF classification, the countries in the Black list are directly related to terrorist financing. As of 2019 Black list of FATF, North Korea and Iran were placed in the Black list. The Grey list serves as a warning to the countries that they may be placed in the Black list if they do not fulfil the FATF standards. As of 2019, the grey list includes Bahamas, Cambodia, Pakistan, Panama, Sri Lanka, Syria, Tunisia and Yemen (Business Standards, n.d).

This study examines the efficacy of the legal regime regarding Anti-Money Laundering (AML) practices in Pakistan. It analyses critically the legal framework of Pakistan concerning AML practices and evaluates the policies adopted to combat the issues related to money laundering in the light of FATF recommendations. The study is divided into four segments. PART I lays down the background and the scheme of the study. PART II

[1] The G7 is the group of seven advanced economies of the world, including Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States, as well as the European Union (EU is non-enumerated member); See Canada and G-7, available at https://www.international.gc.ca/world-monde/international_relations-relations_internationales/g7/index.aspx?lang=eng.

traces the origin and history of money laundering. It highlights the role of international organizations and institutions including FATF in the capacity building of member states to address the issues concerning money laundering. PART III examines the legal framework of Pakistan, its scope, application and efficacy to curb the money laundering practices and also identifies the factors behind money laundering in Pakistan. PART IV concludes the article by making recommendations about how to meet the international standards as well as the implementation of the action plans under recommendations of FATF.

An Overview of Money Laundering

Money laundering refers to the money gained from crimes and through other illegal means. It includes the money acquired through gambling, drugs and human trafficking and extortion. Anti- Money Laundering describes the legal mechanisms to trace, detect and prevent money laundering activities (McDowell & Novis, 2001). The Treasury Department of the United States defined money laundering as a process of making money through illegal proceeds, that is, from dirty to clean money (FinCEN, 2018). FATF defined money laundering as generating profits through the criminal acts and utilizing the gains without disclosing the lawful source of income (FATF, n.d).

The origin of money laundering can be traced back to the ancient times. In 2000 BCE, Chinese merchants used to hide their wealth and gains in order to avoid taxes imposed by the state. These merchants invested their money in remote areas in several businesses to deceive the state treasury; the practice can be linked to modern offshore companies and tax evasion (Seagrave, 1995). In the contemporary era, issues related to money laundering are faced by many states across the globe. The prohibition era in the United States, which extended from 1920 to 1933, witnessed money laundering on a large scale. In 1917, the US Congress prohibited the sale of alcohol through the eighteenth amendment. The amendment was ratified by three-quarter of states making it the law (Prohibition, 2022). Organised criminal activities increased tenfold during the prohibition era. It resulted in the organised transformation of illegal proceeds from bootlegging. The prohibition era is also known as the period of gangsterism.

The process of money laundering requires a significant time, efforts and strategic implementation of conversion (Duhaime's AML, 2018). Once the

money has been laundered, it gains a legitimate status and becomes a part of the mainstream economy. The money is passed through multiple financial transactions to keep the laundering hidden from the law enforcing agencies that have established mechanisms to spot and trace money laundering. The money to be laundered is carried through banks and financial intermediaries. It can take several forms including fake import bills and fabricated transactions.

The process of transforming illegal gains to a legitimate state consists of three stages. The first stage, namely 'Placement' refers to the introduction of illegal finances into the legal financial system in a given state. It is the first stage in money laundering in which the money gained from illegal means is tunnelled into the financial system. For this purpose, banks and other financial institutions are used. At this stage, it is relatively easy to trace the origin and sources of money laundering. The AML mechanism can identify and trace the suspicious transactions. In the second stage, the placement of the money to be laundered is layered. Hence this stage is called 'Layering' in which the money to be laundered is passed through several fabricated transactions using banking channels. The purpose is to conceal the origin and the unlawful sources of the money. Several accounts in multiple banks are used for this purpose. The destination accounts, that is, off-shore accounts and shell companies are selected in jurisdictions with weak regulations. Thirdly, the dispersed money is integrated into the financial system. This stage is called 'Integration'. Following the layering of the funds, the money is integrated as legitimate money. In this stage, the funds are invested into businesses and assets and properties are purchased (Jaffery & Latif, 2020).

The risks and activities of money laundering have increased with the advancement of technology. The United Nations Office on Drugs and Crime identified that more than 1.6 trillion USD were laundered in 2009, constituting 3.6% of the global Gross Domestic Product (Jaffery & Latif, 2020). Following the terrorist attack on September 11, 2001 on the World Trade Organization, the international community realized the need to adopt an interconnected surveillance system to monitor financial transactions. The United States enacted the Patriot Act[2] to address the issues related to

[2] United States of America: Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) [United States of America], 26 October 2001.

terrorist financing. The Act served as a model for other states to adopt the surveillance and monitoring of financial transactions. Since 9/11 attacks, various states have established internal mechanism to fight money laundering primarily to combat terrorist finance. Penalties have been imposed for violating the guidelines (Protess & Silver-Greenberg, 2014). For instance, HSBC Bank was fined $1.9 billion in 2012 for violations and non-reporting of financial transactions. Similarly, strict border controls and banking transaction reporting systems have been made mandatory (Protess & Silver-Greenberg, 2014).

At the international level, FATF has laid down the AML standards to integrate the international financial system against any attempt to tunnel illegal gains for terrorism and other criminal activities (Financial Action Task Force, 2018). FATF was established in the 'Economic Summit of Industrialized Countries' held in 1989. The aim was to develop an international approach against money laundering. The Economic Summit of Industrialized Countries drafted 40 recommendations for the member states to curb the practice of money laundering in their respective jurisdictions. FATF recommendations proved to be an effective tool to curb the menace of money laundering and terrorist financing by adopting a rigorous follow-up mechanism to monitor the implementation and compliance of these recommendations.

Following the Above summit, the United Nations Security Council passed a resolution (Res/1617)[3] urging the member states to implement FATF recommendations (Klein, 2010). In 1988, the United Nations adopted 'Convention against Illicit Traffic in Narcotic Drugs Psychotropic Substances'. Article 3 of the Convention, comprehensively addressed the matters related to money laundering and obligated the state parties to penalize the acts of laundering drug money. Furthermore, the Law Enforcement, Organized Crime and Anti Money Laundering Unit, established in 1997 under the United Nations Office on Drugs and Crime (UNODC), strengthened the international agenda to curb money laundering. The UNODC has played a key role in providing technical assistance to the member states and in establishing the Financial Intelligence Units globally. For instance, the Egmont Group comprising more than 100 member states,

[3] United Nations Security Council. Threats to International Peace and Security caused by Terrorist Acts. Res. 1617, Adopted by the Security Council at its 5244th meeting [29 July 2005].

has developed a secure system to coordinate and transfer financial information between institutions (Egmont Group, n.d).

Anti-Money Laundering (AML) Regime in Pakistan and FATF Recommendations

Pakistan has established a strong AML framework through financial institutions and regulatory bodies. The Securities and Exchange Commission of Pakistan (SECP) serves as a watchdog for companies and the National Accountability Bureau (NAB) monitors anti-money laundering. Furthermore, Anti-Narcotics Force (ANF), the Federal Investigation Agency (FIA), and the Customs Authorities all play an important role to curb the practice of money laundering. FIA has the broader control over organised crime, criminal investigation, operations against terrorism, and counter intelligence. Prior to the establishment of FIA, the Pakistan Special Police Establishment was responsible for investigating the crimes of corruption. In 1974, as a part of police reforms, FIA was established to investigate specialized and organised crimes, human trafficking, counter terrorism, money laundering, cyber-crimes and smuggling (Federal Investigation Agency, 1974). The Economic Crime Wing (ECW) of FIA deals with the offences related to financial crimes, that is, money laundering, hundi, hawala, illegal money transfer services and banking frauds. ECW has defended a number of reports before FATF. For instance, in September 2020, ECW defended a report on illegal Money or Value Transfer Services (MVTs); that was declared 'largely compliant' by FATF. In 2021, ECW defended a report on IO-8 asset recovery and management fulfilling 6 out of 7 recommendations as largely compliant (Federal Investigation Agency, n.d).

The primary law that deals directly with money laundering is the Anti-Money Laundering Act, 2010 (AML 2010). Prior to the enactment of AML 2010, the AML Ordinance 2007 dealt with money laundering matters. It incorporated the regulations for AML and Countering the Financing of Terrorism (CFT). A Financial Monitoring Unit (FMU) was established under the Ordinance. It handles Suspicious Transaction Reports. In addition to the AML Act 2010, significant laws dealing with money laundering and related matters include the Control of Narcotic Substances Act 1997,[4] the

[4] The Control of Narcotic Substances Act of 1997 requires financial institutions to report suspicious transactions. It contains provisions for freezing and seizing the assets linked

National Accountability Ordinance 1999,[5] and the Anti-Terrorism Act 2002.[6]

AML 2010 addresses the money laundering issues in an unprecedented manner. It applies to natural persons and legal entities. It has an overriding effect on previous laws and does not have retrospective effects. The Court in *Muhammad Rafique v Director General, 2021* fortified the provisions of AML 2010 by stating that the Act is non-obstante in nature and overrides other laws including the Criminal Law, the Control of Narcotics Control Act, 1997, the Anti-Terrorism Act, 1997 and the National Accountability Act, 1999. Under the provisions of AML 2010 the burden of proof lies on the accused to prove his innocence beyond the shadow of doubt.

Section 3 of AML 2010 provides a comprehensive definition of the various offences of money laundering.[7] The concealment or changing nature or ownership of the property acquired by illegal means was criminalized. Furthermore, a benamidar owner is held guilty of money laundering, a benamidar owner is a person who holds the property of another person who acquired it for unfair gains and has the knowledge of

with narcotics trafficking. Furthermore, the Act establishes Special Courts to prosecute the offenses related to illegal narcotics.

[5] The National Accountability Ordinance of 1999 also requires the reporting of suspicious transactions and establishes accountability courts.

[6] The Anti-Terrorism Act 2002 defined the crimes of terrorist finance and money laundering. It imposed punishments on such crimes. The Act was amended in 2004 to enhance the level of punishments for the crimes of terrorist financing and money laundering.

[7] Section 3 of the AML Act 2010 defines the offences of money laundering as "A person shall be guilty of offence of money laundering, if the person: (a) acquires, converts, possesses, uses or transfers property, knowing or having reason to believe that such property is proceeds of crime; (b) conceals or disguises the true nature, origin, location, disposition, movement or ownership of property, knowing or having reason to believe that such property is proceeds of crime; (c) holds or possesses on behalf of any other person any property knowing or having reason to believe that such property is proceeds of crime; or (d) participates in, associates, conspires to commit, attempts to commit, aids, abets, facilitates, or counsels the commission of the acts specified in clauses (a), (b) and (c). Explanation-I - The knowledge, intent or purpose required as an element of an offence set forth in this section may be inferred from factual circumstances in accordance with the Qanun-e-Shahadat Order, 1984 (P.O. 10 of 1984). Explanation II.- For the purposes of proving an offence under this section, the conviction of an accused for the respective predicate offence shall not be required.

the fact (Anti-Money Laundering Act, 2010).[8] AML 2010 suggests punishment in line with the recommendations of FATF by confiscating the alleged property, imposing a fine of one million rupees to a natural person and in case of a company a fine of five million rupees may be imposed. Moreover, the guilty person is liable to an imprisonment of one year that may extend to ten years.[9] AML 2010 provides for the establishing of the National Executive Committee (NEC) to supervise and monitor the development and implementation of national strategies. AML 2010 was amended in 2015, following the 3rd Directive of FATF adopted in 2012. The Anti-Money Laundering (Amendment) 2015 regularized the transfer of funds through banking channels as to the previous practice of 'h*awala*' and '*hundi*'.

Since the late 1990s, money launderers have strengthened their roots in Pakistan in different forms. Drug trafficking, smuggling, arms trafficking and other illegal gains have enhanced money laundering posing a real threat to the criminal administrative justice in the state (Yusuf, 2014). Several factors have resulted in the increased number of cases of money laundering in Pakistan. The primary factor behind money laundering is the involvement of prominent financial groups. These financial groups are supported by political and business tycoons. For instance, the Habib Bank Limited New York Branch charged for failure to track the transactions made by a most wanted person in Karachi, who was wanted by the Federal Bureau of Investigation (FBI). The transactions were allegedly linked with a Chinese arms dealer. The transactions were not verified by the bank and were not reported (Baloch, 2017). The New York Department of Financial Services sought to impose a fine of 630 million USD on Habib Bank Limited New York Branch for the violation of AML laws and the Bank Secrecy Act. According to the Department of Finance Services, the Bank was intimated to cover risk management. However, the intimations were ignored by the bank, both by the regional office in New York and the Karachi head office. The Habib Bank New York branch was closed by the consent order to pay

[8] Section 3 of Anti Money Laundering Act 2010 Act no VII of 2010.

[9] In addition, it provides to forfeiture the property involved in money laundering. The fine may extend upto one hundred million rupees in case of a legal person. Any director, officer or employee of such legal person who is also found guilty under this section shall also be punishable.

225 million USD. The case was closed and no clue was left as to the primary culprits (Baloch, 2017).

Similarly, Mrs. Pearl filed a suit in the United States alleging the involvement of Habib Bank Limited in the murder of her husband in 2002. She claimed that the bank had aided and abetted the murder of Daniel Pearl by facilitating the banned charities 'Al Rashid Trust' and 'Al-Akhter Trust International'. She further claimed that Habib Bank had not complied with the AML standards of the United States (Goldstrein, 2007). Mrs Pearl withdrew the case but left several questions unanswered and labelled the financial institutions of Pakistan as Money launderers. In another case, Altaf Khanani, the owner of a leading money exchanger in Pakistan, pleaded guilty in 2016 in United States on account of money laundering (Hussain, 2016). He was charged with 14 counts of money laundering, 13 counts were withdrawn afterwards. Ultimately, he was sentenced for sixty-eight months and charged a fine of 250,000 USD (Hussain, 2017).

In addition to the involvement of prominent groups in money laundering, tax evasion is another factor responsible for money laundering in Pakistan. In order to avoid tax and to gain monetary benefits, funds are transferred abroad in foreign banks accounts or invested otherwise in properties by means of offshore companies. Illegal money is dealt with fake identities and benami ownerships (Qureshi, 2017). Political elites and those in power support such elements. In 2019, the Ex-President of Pakistan Asif Ali Zardari was arrested by FIA for laundering billions of rupees from Pakistan to abroad using benami transactions. The Financial Monitoring Unit of the State Bank of Pakistan (SBP) identified suspicious transactions in a report 'Suspicious Transaction Report'. It tracked more than ten accounts on the suspicion of fake transactions. FIA listed more than 30 benami accounts in the Summit Bank and Sindh Bank used for laundering money. The tunnelled amount was likely received as kick back, commissions and other illegal gains (Ahmed, 2018).

Furthermore, weak control of borders has resulted in the physical transfer of money outside Pakistan. It is comparatively a safe mode to transfer money leaving no marks behind. The disturbance at the Afghan border and tension with India has resulted in economic crisis and instability in Pakistan. Resultantly, a considerable amount of money is transferred physically through its borders. In 2008, Altaf Khanani and Munaf Kalia were arrested by FIA for transferring 1.5 billion USD abroad. A significant

amount of that money was physically transferred through '*hawala*' and '*hundi*'. Due to the lacunas in subsequent investigation and political pressure, both were acquitted in 2011. In 2017, the Ministry of Interior filed an appeal against their acquittal. However, the culprits are still not behind bars (Siddiqui & Fahim, 2013). Another example of physical money laundering is the Ayan Ali case. In 2015, Ayan Ali, a leading model of Pakistan, was arrested from the Islamabad International airport for carrying 508,000 USD illegally. She was granted bail after a payment of 50.5 million rupees. Her name was also removed from the Exist Control List (ECL) by the Supreme Court of Pakistan (Naseer, 2017). These cases reveal the grey side of AML mechanism implemented in the country.

The involvement of political stakeholders and those in power has made the AML mechanism less effective in Pakistan. The ineffective regulatory regime and the lack of political will further exacerbate the situation. Due to the political pressure exerted by political stakeholders, the government offers tax amnesty schemes to legalize the unfair gains. Such schemes attract illegal money holders to pay a nominal share of their wealth in order to legalize the black money.

Corruption is deeply rooted in all public departments across Pakistan (Javaid, 2010). Corrupt elements facilitate money launderers to transfer their illegal money to unknown destinations, while leaving no track record. The proceeds of corruption cannot be kept in bank accounts. Therefore, such money is tunnelled to destinations abroad (Naseer, 2017). In *Imran Ahmad Khan Niazi vs Mian Muhammad Nawaz Sharif, 2017* (Panama Case), the Supreme Court of Pakistan held that millions of dollars have been transferred abroad to establish businesses and for the acquisition of properties in the Middle East and the United Kingdom. The petition was based on 'Panama Papers' and was filed against the then Prime Minister, Muhammad Nawaz Sharif and his family members. The Court elaborated the term 'Money Laundering' by stating that in the absence of any legitimate transactions, involvement of banking channels, and money trail or lawful disclosure, it can be concluded that the money was laundered (Goldstein, 2007).

Despite the deficiencies in implementing the AML framework, the 3rd follow-up report of the Mutual Evaluation Pakistan, 2019 appreciated the progress of Pakistan in addressing the deficiencies in technical compliance. According to the report of Asia Pacific Group, Pakistan has achieved 35

recommendations rated as complaint or largely complaint of total 40 (Asia Pacific Group, 2021). These recommendations include the primary six recommendations concerning criminalizing the offences related to money laundering under recommendation no. 3, terrorist financing offences under recommendation no. 5, sanctions regarding terrorism and their financing under recommendation no. 6, adopting customer due diligence under recommendation no. 10, keeping the record of financial transactions under recommendation no. 11 and reporting of the suspicious transactions under recommendation no. 20. These achievements indicate the sincerity of Pakistan to bring her legal framework on par with international standards (Financial Monitoring, n.d). According to the Mutual Evaluation Report of Pakistan, the state has introduced AML obligations for financial entities as applicable to SBP and SECP. While addressing the deficiencies the regulations of SBP has complaint the screening requirements and technical compliance with FAFT recommendations (Asia Pacific Group, 2021).

Conclusion

Money laundering is linked with organised crimes that affect both the economy and the social well-being of the state. It has negative effects on the integrity of economic policy and causes distortion in the capital market. Money laundering may result in increased activities of traffickers, smugglers and criminals that may attempt to take over legitimate governments (McDowell & Novis, 2001). Underdeveloped and developing countries are more vulnerable to money laundering and terrorist financing. An effective framework to combat AML and terrorism financing endows multi-fold benefits to the country economy and social integration (Sanction Scanner, 2020). Pakistan is one of the developing states that suffers from money laundering and pays a heavy price for illegal transfer of money beyond its borders. The sensitive geographic location and socio-economic factors affecting Pakistan have created a vulnerable situation leading to the adoption of an effective mechanism to fight against financial crimes (Sanction Scanner, 2021).

Recommendations

It is not argued here that the current framework and capacity of state institutions in Pakistan are world class and adequate to meet AML and Combat Financing Terrorism (CFT). However, despite limited resources, Pakistan is committed to achieve the FATF standards laid down to curb the

illegal activities of money launderers. The enhanced customer due diligence and electronic record keeping techniques may help to better implement the planned actions. SBP should simplify the implementation of FATF recommendations. It should focus on the training and capacity building of the employees of financial institutions. The identification and communication of suspicious transactions should be reported to the concerned authorities. The screening of wire transfer transactions should be enhanced. Such transactions are used to layer illegal gains to off-shore companies (Jaffery & Mughal, 2020). The legal framework of Pakistan should be reviewed to cope with the new developments in financial markets. For instance, crypto currency is widely used for laundering purposes across the globe. SBP should frame rules for regulating the alternate financial instruments. The institutions concerned with the drafting of rules and regulations for AML as well as the implementation and investigation of related crimes should be given autonomy. Moreover, such institutions should be depoliticized.

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