3rd Follow-Up Report

Mutual Evaluation of Pakistan

July 2021

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APG Secretariat
Locked Bag A3000
Sydney South
New South Wales 1232
AUSTRALIA
Tel: +61 2 9277 0600

E mail: mail@apgml.org
Web: www.apgml.org

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PAKISTAN: 3rd ENHANCED EXPEDITED FOLLOW-UP REPORT 2021

I. INTRODUCTION

1. The mutual evaluation report (MER) of Pakistan was published in October 2019.

2. This FUR analyses the progress of Pakistan in addressing the technical compliance deficiencies identified in Pakistan's MER. Technical compliance re-ratings are given where sufficient progress has been demonstrated. This report does not analyse any progress Pakistan has made to improve its effectiveness.

3. The assessment of Pakistan's request for technical compliance re-ratings and the preparation of this report was undertaken by the following experts:

- *Qipeng Xu and Gong Jingyan, China*
- *Caroline Dussart and Franck Oehlert, France*
- *Ian Collins, United Kingdom*
- *Suzie White, APG Secretariat*

4. Section IV of this report summarises the progress made to improve technical compliance. Section V contains the conclusion and a table illustrating Pakistan's current technical compliance ratings.

II. FINDINGS OF THE MUTUAL EVALUATION REPORT & FOLLOW UP

5. Pakistan's MER ratings[1] and updated ratings based on earlier FURs[2] are as follows:

R.	Rating
1	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
2	**LC** (MER 2019)
3	**LC** (MER 2019)
4	**LC** (MER 2019)
5	**LC** (MER 2019)
6	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
7	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
8	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
9	**C** (MER 2019)
10	**PC** (MER 2019)
11	**LC** (MER 2019)
12	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)

R.	Rating
21	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)
22	**NC** (MER 2019) ↑ **LC** (FUR Oct 2020)
23	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
24	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
25	**NC** (MER 2019) ↑ **LC** (FUR Oct 2020)
26	**PC** (MER 2019)
27	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)
28	**NC** (MER 2019) ↑ **PC** (FUR Oct 2020)
29	**PC** (MER 2019) ↑ **C** (FUR Feb 2020)
30	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
31	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
32	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)

[1] There are four possible levels of technical compliance: compliant (C), largely compliant (LC), partially compliant (PC), and non-compliant (NC).
[2] Current ratings and the year confirmed are indicated based on the original MER or follow-up re-ratings.

13	**LC** (MER 2019)		33	**PC** (MER 2019)
14	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)		34	**PC** (MER 2019)
15	**PC** (MER 2019)		35	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
16	**LC** (MER 2019)		36	**LC** (MER 2019)
17	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)		37	**PC** (MER 2019) ↓ **NC** (FUR 2020 Oct)
18	**PC** (MER 2019)		38	**NC** (MER 2019)
19	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)		39	**LC** (MER 2019)
20	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)		40	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)

6. Given these results and the effectiveness ratings, Pakistan was originally placed on enhanced (expedited) follow-up[3]. Following its second FUR, Pakistan was removed from enhanced (expedited) follow-up and placed on enhanced follow-up.

III. OVERVIEW OF PROGRESS TO IMPROVE TECHNICAL COMPLIANCE

7. In keeping with the APG Mutual Evaluation Procedures, this FUR considers progress made up until 1 February 2021. In line with the FATF Methodology, the review team analysis has considered the entirety (all criteria) of each Recommendation under review, noting that this is cursory where the legal, institutional or operational framework is unchanged since the MER or previous FUR.

3.1. Progress to address technical compliance deficiencies identified in the MER

8. Pakistan requested re-ratings of the following Recommendations: 10, 18, 26 and 34, which were rated PC in the MER.

9. The APG welcomes the steps that Pakistan has taken to improve its technical compliance with R.10, R.18, R.26 and R.34. As a result of this progress, Pakistan has been re-rated to Compliant on R.10, and to Largely Compliant on R.18, R.26 and R.34.

Central Directorate of National Savings (CDNS)

10. The September 2020 amendments to the Anti Money Laundering Act 2010 (AMLA) establish the framework for CDNS to be subjected to AML/CFT obligations. The National Savings (AML/CFT) Supervisory Board for National Savings Schemes (the CDNS Supervisory Board) has been named as the AML/CFT Regulatory Authority for CDNS (Schedule IV of the AMLA).

11. The National Savings AML and CFT Supervisory Board (Powers and Functions) Rules 2020 (the National Savings Rules) establish the powers and functions of the CDNS Supervisory Board, which include the licensing and registration of REs; the ability to issues regulations, directions and guidelines; monitoring and supervising REs; and, imposing sanctions for non-compliance with AML/CFT obligations. The Supervisory Board has issued National Savings (AML and CFT) Regulations that are applicable to CDNS.

Pakistan Post

12. With respect to the insurance business operated by Pakistan Post, a new entity, Postal Life Insurance Company Limited (PLICL) has been established (incorporated in March 2020), and is licensed, registered, regulated and supervised by SECP. The transfer of Pakistan Post's insurance

[3] APG ME Procedures have three categories of follow-up based on MER results: regular, enhanced and enhanced (expedited).

operations to PLICL was completed on 5 April 2021.

13. With respect to the other financial services previously offered by Pakistan Post, In June 2020 Pakistan Post entered into an agreement with a commercial bank (Habib Bank Ltd (HBL)) for HBL to acquire and manage Pakistan Posts' banking business. HBL is licensed, regulated and supervised by SBP. As a result, Pakistan Post is now a branchless banking super-agent for HBL, in accordance with SBP's Branchless Banking Regulations. Legacy accounts are being either transferred to HBL's platform, transferred to CDNS or paid out, depending on balances and other factors.

14. As part of this new framework, Pakistan Post established an AML/CFT Supervisory Board in October 2020, which issued AML/CFT Regulations for Pakistan Post. The purpose of the Supervisory Board is to provide a temporary supervision mechanism for the remaining services provided by Pakistan Post during the transition period for the transfer of the insurance and banking businesses. The transfer of the banking business banking business is expected to be complete by January 2022.

Recommendation R.10 (Originally rated PC)

15. Pakistan was rated PC in its 2019 MER. The report noted that CDNS and Pakistan Post were not subject to AML/CFT requirements. There was a lack of requirements for micro-finance bank (MFBs) and exchange companies (ECs) to undertake customer due diligence (CDD) measures when there are suspicions of ML/TF or doubts about the veracity or adequacy of previously obtained customer identification data. There were shortcomings in CDD requirements for banks and development financial institutions (DFIs) to identify and verify occasional customers and for banks, DFIs and ECs to perform enhanced due diligence (EDD) where the ML/TF risks are higher. There was also a lack of requirements for banks, DFIs, MFBs to terminate the business relationships where they are unable to comply with relevant CDD measures.

16. **Criterion 10.1** is *met*. Since its MER, Pakistan has substantially revised its AML/CFT legislative and regulatory framework. The amended AMLA prohibits REs from entering business relationships or conducting any transactions with a customer who is anonymous or provides a fictitious name (s.7E). The AMLA definition of REs includes all FIs covered under the definition in the FATF Glossary and now captures CDNS and the financial activities previously provided by Pakistan Post.

17. **Criterion 10.2** is *met*. The amended AMLA requires FIs, including MFBs and ECs, to undertake CDD measures when entering into a business relationship, conducting an occasional transaction above the prescribed threshold, there is a suspicion of ML/TF or there are doubts about the veracity or adequacy of previously obtained data (s.7(A)). This requirement is also included in new regulations issued by all the AML/CFT regulatory authorities (SBP, SECP and Supervisory Board).

18. The AMLA defines "occasional transactions" as any transaction conducted by a RE for a customer with whom the RE does not have a business relationship and defines "prescribed" as meaning prescribed by rules or regulations made under the AMLA (s.2). The new regulations issued by SBP and CDNS and SRO 105(1)/2020 issued by SECP require CDD to be carried out on all occasional transactions. As such, all transactions carried out by occasional customers are subject to CDD measures regardless of value.

19. **Criterion 10.3** is *met*. The amended AMLA requires REs to identify the customer and verify the customer's identity on the basis of documents, data or information obtained from reliable and independent sources (s.7A(2)(a)).. There are additional binding obligations for FIs to identify customers and to verify customers' identities in the new regulations issued by each of the AML/CFT Regulatory Authorities.

20. SBP regulated persons, including banks, DFIs, MFBs and ECs, are required under SBP Regulation 2 to apply CDD measures in accordance with s.7A(2) of the AMLA (s.2). Further, SBP regulated persons are required to identify and verify the identity of customers and occasional customers using, at a minimum, the information and documents set out in detail in Annexure I and II of the

Regulation (s.3,4). For natural persons, this includes a copy of CNIC or other applicable valid identity document. For legal persons, this includes a copy of the applicable valid identity document of the account holder(s) as well certified copies of the registration/incorporation documents relevant to the specific type of legal person. For legal arrangements, this includes copies of applicable valid identity documents and certified copies of the certificate of registration/instrument of trust, by-laws and rules and regulations, and documentation from the ultimate governing body authorizing the person(s) to open and operate the account. While ECs are subject to these obligations, they are also prohibited under the EC Manual from dealing with almost all legal persons and arrangements (with the exception of banks and other exchange companies) and may only deal with natural persons that are occasional customers (s.8A).

21. SECP regulated persons are required to identify the customer and verify the customer's identity using reliable and independent documents, data and information (s.9 Chapter II, SECP Regulations). Annex I to the regulation sets out the documents, data and information that may be used. These are broadly consistent with those set out in the SBP regulations as set out above and meet the requirements of R.10. The term 'customer' is broadly defined to mean any natural person, legal person or legal arrangement to whom financial services have been extended by a regulated person.

22. CDNS and Pakistan Post must identify and verify the identity of customers using reliable and independent documents, data or information (s.4(2), Chapter III National Savings and Pakistan Post Regulations). Section 4(9) sets out these and other permitted independent documents, data and sources of information that may be used. The term 'customer' includes any person engaging for the purposes of requesting, acquiring or using any services or carrying out any transaction or business with CDNS, which is sufficiently broad to capture both permanent and occasional customers.

23. **Criterion 10.4** is *met.* SBP regulated persons, including ECs, banks, DFIs and MFBs, are required to verify that any person purporting to act on behalf of the customer/occasional customer is so authorised and to identify and verify the identity of that person using reliable and independent documents, data or information (s.7, SBP Regulation 2). Updated SECP regulations maintain obligations in keeping with this criterion on SECP regulated persons (s.10 Ch 11, SECP Regulations).

24. Under the National Savings and Pakistan Post Regulations, CDNS and Pakistan Post are required, where the customer is represented by an authorised agent or representative, to verify the authority of that person to act on behalf of the customer and to identify and verify the identity of that person using reliable and independent documents, data or information (s.4(3) Chapter III).

25. **Criterion 10.5** is *met.* The amended AMLA requires all FIs to identify the BO and take reasonable measures to verify the BO's identity on the basis of documents, data or information obtained from reliable sources and be satisfied that it knows who the beneficial owner (BO) is (s.7A(2)(b)). The definition of 'beneficial owner' in the AMLA mirrors the definition in the FATF Glossary. Additional binding obligations apply to FIs to identify customers and to verify customers' identities in the new regulations issued by each of the AML/CFT Regulatory Authorities.

26. Section 8 of the SBP Regulations require SBP regulated persons, including ECs, to identify the BO(s) and take reasonable measures to verify their identity using reliable and independent documents, data or sources of information as set out in detail in Annexures I and II to the Regulations, such that the regulated person is satisfied that it knows who the BO is. The term 'beneficial owner' is defined as having the same meaning as the AMLA. SECP regulated persons, CDNS and Pakistan Post are subject to equivalent obligations (s.11 Chapter II, SECP Regulations; s.4(4) Chapter III, National Savings and Pakistan Post Regulations).

27. **Criterion 10.6** is *met.* The amended AMLA now requires FIs to understand and, as appropriate, obtain information on the purpose and intended nature of the business relationship (s.7A(2)(c)).

28. **Criterion 10.7** is *met*. The amended AMLA now establishes that all FIs must monitor business relationships on an ongoing basis (s.7A(2)(d)). There are further regulatory requirements for FIs to undertake ongoing monitoring, including scrutiny of transactions to ensure they are consistent with the FI's knowledge of the customer, its business and risk profile (and where appropriate the source of funds), and to ensure that documents, data, and information are kept up-to-date particularly for higher risk categories of customers (s.20(b)(d) SBP Regulations; s19 SECP Regulations; s4(13) National Savings and Pakistan Post Regulations).

29. **Criterion 10.8** is *met*. Financial institutions are required to understand the nature of the customer's business and its ownership and control structure where such customer is a legal person or legal arrangement (s.2,9(ii) SBP Regulations, s.12(2) SECP Regulations, s.4(5) National Savings and Pakistan Post Regulations).

30. **Criterion 10.9** is *met*. As per the MER, where a customer is a legal person or arrangement, SBP and SECP FIs are required to identify the legal form, constitution and powers that regulate and bind the legal person or arrangements. These FIs are required to identify the connected parties of the customer, by obtaining at least the following information of each connected party: registration/incorporation number or business registration numbers, full name as per identity document and registered business address or principal place of business.

31. Where a customer is a legal person or arrangement, CDNS and Pakistan Post are required to identify the customer and verify its identity by obtaining: i) name, legal status and proof of existence; ii) the powers that regulate and bind the legal person or arrangement, as well as the names of the relevant persons having a senior management position in the legal person or arrangement; and iii) the address of the registered office and, if different, a principal place of business (s.4(6) Chapter III, National Savings and Pakistan Post Regulations).

32. **Criterion 10.10** is *met*. All FIs are required to identify and take reasonable measures to verify the identity of BOs for customers that are legal persons in the manner required under c.10.10 (s.10(a)-(c), SBP Regulations; s13(1)(a)-(c) SECP Regulations; s.7(a)-(c) National Savings and Pakistan Post Regulations).

33. **Criterion 10.11** is *met*. All FIs are required to identify and take reasonable measures to verify the identity of BOs for customers that are legal arrangements in the manner required under c.10.11. In addition, where any of the persons specified is a legal person or arrangement, the FI is also required to identify the BO of that legal person or arrangement (s.11(a)-(b) SBP Regulations; s.14(a)-(b) SECP Regulations; s.8(a)-(b) National Savings Regulations; and s.7(a)-(c) Pakistan Post Regulations).

34. **Criterion 10.12** is *met*. The products provided by CDNS include certificates, accounts, prize bonds and premium prize bond. CDNS does not engage in transactions pertaining to life insurance policies. Therefore, the requirements at c.10.12 are not applicable to CDNS. Insurers and takaful operators are required to undertake CDD measures for the beneficiaries of life insurance, takaful and other related policies as soon as those beneficiaries are identified or designated. Section 15 of the SECP Regulations closely mirrors the requirements of c.10.12(a),(b) and (c), respectively.

35. **Criterion 10.13** is *met*. Insurers (including takaful operators) are required to include the beneficiary as a relevant risk factor in determining whether EDD measures are applicable (s.21(3) SECP Regulations). The products provided by CDNS include certificates, accounts, prize bonds and premium prize bond. CDNS does not engage in transactions pertaining to life insurance policies. Therefore, c.10.12 is not applicable to CDNS.

36. **Criterion 10.14** is *met*. The SBP Regulations apply to all SBP regulated persons including ECs. SBP regulated persons are required to complete the verification of the identity of the customer, occasional customer and BO before establishing a business relationship or conducting the occasional transaction or during the course of establishing a business relationship or occasional transactions (s.15

SBP Regulation 2).

37. CDNS and Pakistan Post are required to verify the identity of the customer and BO before establishing a business relationship or during the course of establishing a business relationship. CDNS may complete verification after the establishment of the business relationship, provided that this occurs as soon as reasonably practicable; does not interrupt the normal conduct of business; and the ML/TF risks are proven to be low (s.4 10, 11 National Savings and Pakistan Post Regulations).

38. SECP regulated persons are required to verify the identity of the customer and BO before establishing a business relationship, or during the course of establishing a business relationship (s.16 SECP Regulations). SECP regulated persons may complete verification after the establishment of the business relationship, provided that this occurs as soon as reasonably practicable; does not interrupt the normal conduct of business; and the ML/TF risks are effectively managed (s.17(1)(a)-(c)).

39. **Criterion 10.15** is *met.* CDNS and Pakistan Post are required to have and implement risk management procedures concerning the conditions under which a customer may utilize the business relationship prior to verification (s.4(12) Chapter III, National Savings and Pakistan Post Regulations). Under Section 15 of the SBP Regulations, SBP REs are not permitted to complete verification after the establishment of the business relationship. Therefore, criteria 10.15 does not apply to SBP REs. The requirements for SECP regulated persons remain unchanged under the SECP Regulations.

40. **Criterion 10.16** is *met*. All FIs have obligations in sectoral regulation that mirror the requirements of the FATF standards to apply CDD requirements to existing customers on the basis of materiality and risk, and to conduct due diligence on existing relationships at appropriate times in in the manner required under c.10.10 (s.21 SBP Regulation 2; s.20(1) Chapter II, SECP Regulations; s.4(14) Chapter III National Savings and Pakistan Post Regulations).

41. **Criterion 10.17** is *met.* All FIs have obligations in sectoral regulation that mirror the requirements of the FATF standards to perform EDD where the ML/TF risks are higher (s.15(a) SBP Regulations; s.21(1)(a) Chapter II SECP Regulations; s.4(16)(a) Chapter III National Savings and Pakistan Post Regulations).

42. **Criterion 10.18** is *met.* Under Section 17 of SBP Regulation 2, SBP regulated persons may only apply simplified due diligence (SDD) where low risk has been identified. Regulated persons are required under Regulation 1 to evaluate ML/TF risks on the basis of an Internal Risks Assessment Report (IRAR) and formulate policies for the application of SDD where low ML/TF risks are identified through their IRAR or as prescribed by SBP. Regulated persons are not permitted to apply SDD whenever there is a suspicion of ML/TF (s.18). There are equivalent provisions in SECP (23(1)), National Savings and Pakistan Post Regulations (3(3) and 4(19)).

43. **Criterion 10.19** is *met.* The AMLA establishes obligations for all FIs to follow where they are unable to comply with their CDD requirements (s.7(d)). The Act requires that FIs either not open the account, commence business relations or perform the transaction; or must terminate the business relationship (if any). FIs are required to promptly consider filing a suspicious transaction report (STR) in relation to the customer.

44. **Criterion 10.20** is *met*. All FIs, including ECs, are required to stop pursuing the CDD process and file an STR instead where the FI has formed a suspicion of ML/TF and reasonably believes that performing the CDD process will tip-off the customer (s.7D(2), AMLA).

Weighting and conclusion

45. Pakistan has introduced comprehensive AML/CFT obligations for CDNS and the entities that provide the financial activities previously provided by Pakistan Post are subject to the same AML/CFT obligations as other SBP and SECP regulated persons. MFBs and ECs are also now subject to the same AML/CFT obligations as other SBP regulated persons. ***Recommendation 10 is re-rated to Compliant.***

Recommendation R.18 (Originally rated PC)

46. Pakistan was rated PC with Recommendation 18 in its 2019 MER. The report found that, except for regulated persons, there was no explicit requirement for all FIs to implement programmes against ML/TF which have regard to the ML/TF risks and the size of the business, and there was a lack of requirements to give effect to c.18.2 for all FIs.

47. **Criterion 18.1** is *met.* Since the MER, the amended AMLA introduces requirements for compliance programs to have regard to ML/TF risks and the size of the business (s.7G). This obligation applies to all REs, including DFIs, money service businesses (MSBs) and ECs and rectifies the deficiency noted in the MER.

48. In relation to employee screening:

a. The SBP Regulations set out requirements for compliance programs of SBP-regulated FIs and require FIs to develop and implement appropriate screening procedures to ensure high standards and integrity at the time of hiring all employees, whether contractual or permanent or hired through outsourcing for hiring employees (13(9)(a-c)).The SECP Regulations set out requirements for compliance programs of SECP-regulated FIs and requires screening requirements for hiring employees (27(1)(b)).

b. In relation to CDNS, the amended AMLA provides that Regulatory Authorities shall issue regulation in respect of section 7A to 7H including compliance programs under 7G and impose sanction for the violation of requirements set out in 7A to 7H and any regulation made thereunder (s.6A (2)(d)). The National Savings Regulations require CDNS to implement internal policies, procedures and controls as per the FATF standards (Chapter-V Regulation-6 (2)) and any violation should be subject to sanctions in accordance with Chapter IX of the aforementioned Regulation.

c. The Pakistan Post Regulations require PPOD to have and implement the following internal policies, procedures and controls: (a) compliance management arrangements (including the appointment of a compliance officer at the management level); (b) screening procedures to ensure high standards when hiring employees; (c) an ongoing employee training programme; and (d) an independent audit function to test the system, as required under c.18.1 (Chapter-V Regulation-6 (1)).

49. **Criterion 18.2** is *mostly met.* The AMLA defines Corporate Group as a group that consists of a parent entity exercising control or management on a branch or subsidiary that is subject to AML/CFT policies and procedures at the group level. This largely aligns with the FATF definition of financial groups.

50. Regulation 15(4) of the SBP Regulations set out obligations largely in line with c.18.2, however it does not specify that the information shared between group-level compliance/ audit/ AML/CFT functions and branches and subsidiaries should include information and analysis of transactions or activities which appear unusual.

51. Pakistan Post is a department of the Ministry of Communications, Government of Pakistan and therefore does not fall under the definition of the 'corporate group' in the AMLA.

52. **Criterion 18.3** is *met* (as per MER). The analysis in the MER and available material supports the criterion rating.

Weighting and conclusion

53. Since the MER Pakistan has addressed the deficiencies with compliance programs against AML/CFT having regard to the ML/TF risk and the size of the business. Pakistan has also addressed deficiencies with respect to the employee screening requirements for banks and DFIs with new

provisions in SBP and SECP Regulations. Amendments have been passed in the CDNS and Pakistan Post Regulations to provide enforceable AML/CFT requirements. However, minor deficiencies remain with the SBP Regulation coverage of requirements for financial groups. ***Recommendation 18 is re-rated Largely Compliant.***

Recommendation R.26 (Originally rated PC)

54. Pakistan was rated PC with Recommendation 26 in its 2019 MER. The report noted that Pakistan lacked a framework to conduct risk-based supervision and that no risk-based supervision manuals had been issued. There were a lack of requirements for banks, DFIs, MFBs, ECs and modarabas to include within its scope of its fit and proper tests relevant to beneficial owners. CDNS and Pakistan Post were not supervised for AML/CFT requirements.

55. **Criterion 26.1** is *met*. In relation the CDNS, the amended AMLA defines the National Savings Supervisory Board as the supervisory body for CDNS. Section 6A(2)(f) authorises the CDNS Supervisory Board with powers to monitor/supervise, including conducting on-site inspections for the purpose of ensuring compliance of requirements set out in the AMLA by CDNS and its regional offices. The National Savings Rules clarify its constitution, powers and functions. The Board issued the National Savings Regulations which set out detailed AML/CFT requirements including CDD/BO, record keeping, targeted financial sanctions (TFS) and reporting of STR and cash transaction reports.

56. As referred to above, Pakistan has carried out a reform on Pakistan Post since its MER, and financial service businesses have been/are being taken over by a newly established FI (PLICL) and a contracted commercial bank (HBL). Both the PLICL and HBL are licensed and regulated FIs, and are subject to a full range of AML/CFT obligations and supervision. Pakistan established the Pakistan Post Supervisory Board to oversee compliance of AML/CFT requirements during the transition period. The amended AMLA (s.6A) identifies the Supervisory Board as the AML/CFT regulatory authority for Pakistan Post. The Supervisory Board issued the Pakistan Post Regulations for compliance of AML/CFT.

57. **Criterion 26.2** is *mostly met.* CDNS is a statutory body attached to the Ministry of Finance whose 'licence' to operate is derived from statute. CDNS sells government domestic debt securities to the general public. CDNS staff are government employees and the government owns all assets and liabilities of CDNS. Thus, CDNS is not subject to licensing requirements under this criteria. As noted above, the PLICL and the commercial bank are subject to market entry licencing obligations, as-per the MER analysis of the SBP licensing requirements.

58. Pakistan provided additional material to confirm the basis on which it does not approve the establishment, or continued operation, of shell banks. As per its MER, shell banks do not have an explicit prohibition but there are measures in place which would preclude them operating in Pakistan. These include having a registered office and physical place of business (s.21 and 22, Companies Act 2017); providing the location of said office (Rule 10(IV) of BCO, 1962); and requiring banks to obtain a certificate from SBP with no objections as per the SBP guidelines.

59. **Criterion 26.3** is *mostly met*. In relation to SBP-regulated entities, the updated SBP Regulations prohibit any person(s) linked to criminal activities or affiliated with any terrorist organisations from becoming part of SBP RE (Regulation 15-1). This includes banks, DFIs, MFBs, ECs, payment systems operators, payment service providers, electronic money institutions, third party payment service providers. Regulation 15-2 prohibits anyone who does not comply with fit and proper requirements from being a sponsor shareholder/BO, director, president and/or key executive of a RE, including if the person is or associated directly/indirectly with designated person/ proscribed person, or, convicted of, or associated directly/indirectly, with any person convicted of any offence. Regulation 15-3 requires REs to verify the person subject to FPT through the National Database & Registration Authority and sanction list.

60. In relation to Modarabas, SECP Circular No. 19 amended Regulation 5 of Part-IV of Prudential Regulations for Modarabas. This new regulation provides that, if the promoter or major shareholder of a Modaraba is a legal person, then the fit and proper test shall apply to the BO of the legal person. Another new provision provides that the behaviour as well as integrity and track record of promoters and BO should be assessed. This addresses the deficiency identified in the MER.

61. CDNS is an attached department of the Ministry of Finance; therefore, criterion 26.3 is not applicable to CDNS as all appointments are made after verification of character and experience. Pakistan Post is a department of the Ministry of Communications and all appointments are made after verification of character and antecedents, therefore criterion 26.3 is also not applicable. As for HBL, it is subject to the above mentioned SBP regulation. The PLICL is subject to fit and proper criteria set out in the Insurance Companies (Sound and Prudent Management) Regulations 2012 (Articles 2 & 3), in line with the 2019 MER.

62. **Criterion 26.4** is *mostly met.*

63. Criterion 26.4(a) - Since the adoption of the MER, no follow up assessments against the IOSCO and IAIS principles have been undertaken in Pakistan. The SECP carried out a number of legislative, operational and institutional reforms to improve its overall compliance status, in particular on principles rated as partially compliant (namely IOSCO principle 24, ICP 5, 7-10, 18, 22, 23, 25).

64. Criterion 26.4(b) - CDNS is subject to AML/CFT regulation and supervision by the CDNS Supervisory Board. In September 2020, the Supervisory Board issued Regulations; approved a Risk Based Supervisory Framework for conducting on-site and off-site supervision; issued an enforcement policy as well as guidelines on implementation of risk assessment, TFS, ML/TF/PF red-flags, and politically exposed persons (PEPs). The CDNS Supervisory Board has also carried out off-site assessments.

65. In relation the transfer of Pakistan Post FIs, both the PLICL and HBL are licensed and regulated FIs by the SECP and the SBP. To oversee compliance with AML/CFT requirements by those accounts pending transfer to other FIs, Pakistan Post Supervisory Board has been established to oversee compliance during the transition period. Various steps have been taken, including on-site inspections and enforcement actions.

66. **Criterion 26.5** is *mostly met.*

67. Criterion 26.5(a) - The SBP developed the AML/CTF/CPF Manual 2020 for banks, DFI, MFBS and ECs. The manual contains a Risk Based Supervisory Framework under which the SBP assesses the inherent risk of RE as well as the quality of internal controls. Based on the results, the SBP determines the 'net risk' for each institution using, a risk assessment tool. The 'net risk' is assigned into one of four categories; 'low', 'moderate', 'above average' and 'high'. Each specific category of 'net risk' serves as the basis in determining the frequency and intensity of supervisory actions. The SBP has started to carry out risk based supervision in line with the manual. There is no similar requirement for financial groups (i.e. the abovementioned requirement applies solely to REs).

68. The SECP also issued a supervisory manual in 2019 which contains a risk based supervisory framework. The SECP's risk assessment considers the inherent ML/TF risk and vulnerability of a FI, as well as the results of the national risk assessment (NRA), sectoral risk assessments (SRA) and information from other sources. A risk rating (low, moderate, above average or high) will be assigned to each regulated institution and will be reviewed after each supervisory activity.

69. The CDNS Supervisory Board approved the National Savings AML CFT Board Risk-Based Supervisory Framework, which sets out a supervisory framework and approach of ML/TF risk assessment for CDNS. This approach sets out a four-tiered risk rating matrix which looks at ML/TF risk from aspects of products and services, customer, geographic reach, and delivery channels. Risk monitoring information will be reported to the Board half yearly which will assist the Board to target its

supervisory efforts. The CDNS Board has started to carry out risk based supervision.

70. The Pakistan Post Supervisory Board approved a supervisory framework which consists of a risk matrix based on a four-tied risk rating. This risk matrix assess inherent vulnerabilities of Pakistan Post i.e. products and services, clientele, geographic reach, and delivery channels, as well as the quality of mitigating controls. During the transitionary period, the Supervisory Board is conducting offsite monitoring and analysis of the legacy portfolio transfer process and taking subsequent onsite actions.

71. Criterion 26.5(b) - In line with the SBP's supervisory framework, the results of the NRA, together with factors including financial intelligence and customer risk factors will be considered in assessing the inherent risk of FI activities. SECP's risk assessment considers the inherent ML/TF risk, vulnerability, as well as the results of the NRA, SRA and information from other sources. The CDNS supervisory framework, provides that the outcome of the NRA, SRA and CDNS specific risk assessments be considered. The Pakistan Post supervisory framework consists of a risk matrix that includes data from the NRA as well as a risk questionnaire, and CDNS' internal risk assessment was also considered.

72. Criterion 26.5(c) - In line with the SBP's supervisory framework, structural risk including overseas presence, years of operation, beneficial structure, together with various other factors, will be considered when assessing the inherent risk of a FI. This does not however extend to financial groups, as required by c.26.5(c). The SECP's risk assessment requires REs to consider the size, ownership and corporate structure and entity's characteristics when assessing inherent risk. The CDNS supervisory framework provides that the outcome of NRA, SRA as well as CDNS specific risk assessments be considered. The Pakistan Post supervisory framework consists of a risk matrix which includes the consideration of result of a risk questionnaire and CDNS' internal risk assessment.

73. **Criterion 26.6** is *mostly met*. The SBP Inspection Manual requires risk profiles of SBP REs to be updated annually (Para 1, Sub Section 4.2 of Section-I), or in response to major developments (e.g. the NRA), emerging or new risks or in response to feedback received from the financial intelligence unit (FMU) or law enforcement (Sub-section 5.3 & 5.4 of Section I). While there is no explicit requirement for the supervisor to review the ML/TF risk profile when there is a change in management, all changes to management are required to be approved by SBP.

74. There is no prompt for the SBP to revise the risk assessment when there is a change in the management or operations of a FI or group[4]. However, in practice the SBP obtains information relevant to operations during supervisory activities (onsite inspections or control assessment questionnaires) and adjusts the risk assessment accordingly. SBP Regulations (Reg 1(7)) require REs to periodically update their risk assessments, including when circumstances change, and to provide updated risk assessments to their supervisors as and when required.

75. The SECP RBS Inspection Manual requires SECP inspection staff to evaluate whether the risk rating for an entity is appropriate and to adjust accordingly after each examination. New and emerging risks are required to be considered as part of the assessment of risk (Para 4, Annex A). Section 8(b) of the Inspection Manual requires Institutional Profiles to be updated on an annual basis, and risk profile to be updated when relevant significant developments occur (including a change in shareholding, a major change in the business model or a change to the supervisory strategy). SECP issued SRO 920 (I)/2020 which requires regulated entities to submit risk assessments and quarterly information to the SECP. There is no explicit requirement for the SECP to review the ML/TF risk profile of a FI or group when there is a change in management.

[4] SBP approved an amended AML/CFT&PF Inspection Manual on 24 February 2021, after the cut-off date for this follow-up report. Pakistan reported that the deficiencies regarding the lack of explicit provisions for SBP to revise risk assessments/profiles of FIs and financial groups in response to changes in management and operations have been addressed in the amended Inspection Manual. The review team did not consider the provisions set out in the amended Inspection Manual.

76. The CDNS Supervisory Board has implemented a comprehensive Risk-Based Supervisory Framework and Inspection Manual. The Board collects information on AML/CFT compliance and ML/TF risk through half yearly compliance report, yearly off-site ML/TF risk questionnaire to update the risks periodically and to decide further supervisory actions.

77. As discussed above, the Pakistan Post Supervisory Board implemented a supervisory framework to oversee the transition period. The commercial bank and the PLICI are supervised REs of the SBP and are subject to SBP's RBA regime explained above.

Weighting and conclusion

78. Deficiencies remain with respect to obligations for financial groups and a lack of explicit provisions for SBP to revise risk assessments of REs or financial groups in response to developments in their management and operations. Gaps will remain with Pakistan Post's compliance with c. 26.2 until the transfer of its business banking has concluded. ***Pakistan is re-rated to Largely Compliant with R.26.***

Recommendation R.34 (Originally rated PC)

79. Pakistan was rated PC with Recommendation 34 in its MER. The report found that feedback outside formal consultation mechanisms and feedback to all DNFBPs was lacking. Pakistan Post and CDNS had not received any AML/CFT guidance.

80. **Criterion 34.1** is *mostly met.* The AMLA requires AML/CFT regulatory authorities to issue guidelines and provide feedback to REs in relation to their obligations under the Act (s.6A(2). Since the MER, authorities in Pakistan have issued a wide range of guidance materials relevant to all REs, including guidelines relating to TFS obligations for TF and PF, implementing the risk-based approach (RBA) to AML/CFT during the COVID-19 pandemic and guidance on ML/TF risks during the pandemic.

81. Since the MER SBP has held compliance forum meetings, issued guidelines (including on implementation of TFS obligations), issued a red flag indicators document to REs, conducted outreach sessions (including on TFS obligations, trade based ML, non-profit organisation risks). Further, SBP has shared relevant intelligence information with REs to support implementation of their obligations.

82. SECP has issued guidelines on TFS obligations, red flags on associates of proscribed entities, the RBA and FAQs on NRA 2019, delivered awareness sessions on TFS and TF, conducted compliance forums for senior management and issued letters to REs regarding general feedback on STRs in light of guidance received from FMU.

83. CDNS has issued guidelines on compliance with TFS obligations and delivered awareness sessions on obligations, risks, red flags and reporting and penalties.

84. FMU has:

a. Issued multiple guidance documents for REs (including sector specific red flag indicators that are available on the FMU website).

b. Held compliance forums to discuss sector specific concerns, risks and typologies.

c. Held meetings with REs with significant compliance issues to provide feedback and information on consequences of non-compliance, emerging threats and patterns.

d. Issued compliance letters to individual REs on reporting issues.

e. Held outreach sessions on feedback of report quality and areas of improvement, case studies, legislative amendments and reporting requirements.

85. Minor deficiencies exist with respect to the sector-specific red flag indicators, including that they are undated, with no plan to periodically update the indicators, and that the indicators contained

within are largely generic.

86. FMU issues quarterly newsletters on the steps it has taken to improve compliance with AML/CFT requirements, legislative and regulatory amendments/issuances, reporting trends, strategic analysis, typologies and case studies. FMU also issues statistical reports, typologies reports, strategic analysis and sectoral analysis. The FMU's website also contains a series of in-depth and informative YouTube streams for various sectors, which have been produced over the past 12 months.

87. Pakistan provided a sample of feedback from attendees of various outreach sessions which reviewers note was largely positive. The guidance issued and feedback provided by Pakistan since the MER has expanded the scope outside the formal consultation mechanisms, largely addressing the deficiency identified in the MER.

88. With respect to DNFBPs, the general guidance issuances noted above apply to DNFBPs, including the TFS guidance and FMU products on STR reporting and ML/TF risk. FMU has issued sector specific red flag indicator guidelines for the real estate sector, lawyers, notaries and independent legal professionals, jewellers and precious metals/stone dealers, and accountants. The deficiencies noted above with respect to the red flag documents also apply to DNFBPs.

89. Supervisors of accountants (Federal Board of Revenue, Institute of Chartered Accountant of Pakistan (ICAP) and Institute of Cost and Management Accountants (ICMA) of Pakistan) have issued a range of guidelines on AML/CFT obligations, reporting and TFS. ICAP and ICMA have delivered interactive awareness webinars and issued FAQ documents. The NRA and sectoral risk assessment were disseminated by ICAP and accountant supervisors have delivered outreach sessions in collaboration with the UN Office of Drugs and Crime (UNODC).

90. With the assistance of the Asian Development Bank, Pakistan developed sector-specific compliance program manuals to support DNFBPs understand their AML/CFT and TFS obligations. The Accountants and Real Estate documents were published in December 2020 and the dealers in precious metals stones document in January 2021.

91. Limited guidance and feedback has been provided to the legal sector, noting the Regulations are pending.

Weighting and conclusion:

92. Pakistan has issued a wide range of guidance and conducted feedback sharing sessions with REs to support their implementation of their obligations, which largely aligns with ML/TF risk. Minor deficiencies remain with respect to the limited sector specific feedback and guidance issued to lawyers, and with the quality of the red flag indicators issued to REs. ***Pakistan is re-rated to Largely Compliant with R.34.***

IV. CONCLUSION

93. Pakistan has made good progress in addressing the technical compliance deficiencies identified in its MER and has been re-rated on R.10, R.18, R.26 and R.34. Recommendation 10 has been re-rated to Compliant, and R.18, R.26 and R.34 to Largely Compliant.

94. Overall, in light of the progress made by Pakistan since its MER was adopted, its technical compliance with the FATF Recommendations as follows as of the reporting date February 2021.

R.	Rating
1	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
2	**LC** (MER 2019)
3	**LC** (MER 2019)
4	**LC** (MER 2019)
5	**LC** (MER 2019)
6	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
7	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
8	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
9	**C** (MER 2019)
10	***PC** (MER 2019) ↑ **C** (FUR Feb 2021)*
11	**LC** (MER 2019)
12	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
13	**LC** (MER 2019)
14	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)
15	**PC** (MER 2019)
16	**LC** (MER 2019)
17	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
18	***PC** (MER 2019) ↑ **LC** (FUR Feb 2021)*
19	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)
20	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)

R.	Rating
21	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)
22	**NC** (MER 2019) ↑ **LC** (FUR Oct 2020)
23	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
24	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
25	**NC** (MER 2019) ↑ **LC** (FUR Oct 2020)
26	***PC** (MER 2019) ↑ **LC** (FUR Feb 2021)*
27	**PC** (MER 2019) ↑ **C** (FUR Oct 2020)
28	**NC** (MER 2019) ↑ **PC** (FUR Oct 2020)
29	**PC** (MER 2019) ↑ **C** (FUR Feb 2020)
30	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
31	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
32	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
33	**PC** (MER 2019)
34	***PC** (MER 2019) ↑ **LC** (FUR Feb 2021)*
35	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)
36	**LC** (MER 2019)
37	**PC** (MER 2019) ↓ **NC** (FUR 2020 Oct)
38	**NC** (MER 2019)
39	**LC** (MER 2019)
40	**PC** (MER 2019) ↑ **LC** (FUR Oct 2020)

95. Pakistan has 35 Recommendations rated C/LC. Pakistan will remain on enhanced follow-up, and will continue to report back to the APG on progress to strengthen its implementation of AML/CFT measures. Pakistan's fourth progress report is due 1 February 2022.