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Sanctioning Afghanistan via the FATF and Possible Repercussions for Pakistan

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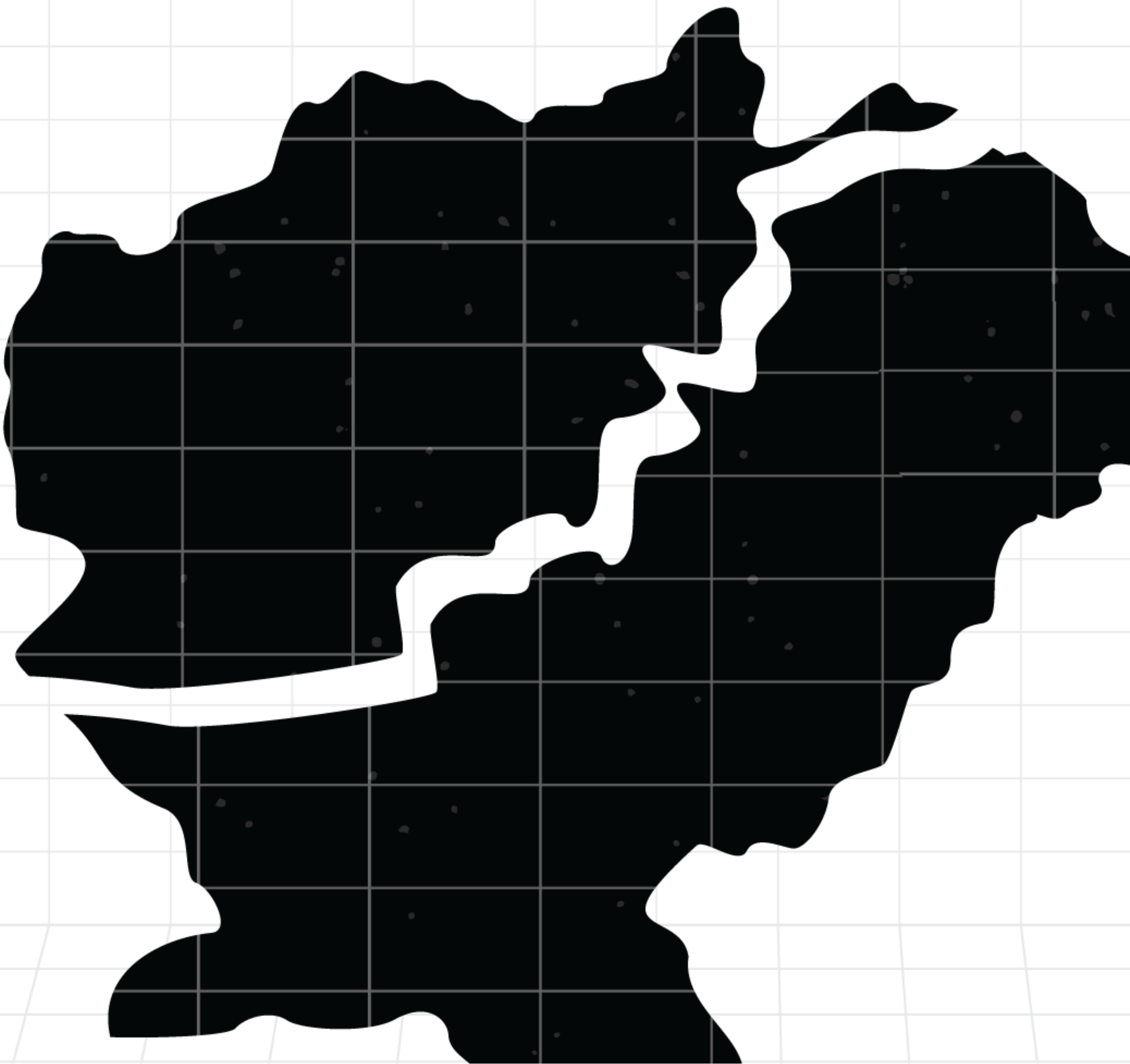

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INTRODUCTION

The Taliban takeover of Afghanistan continues to shock the international community, generating critical discourse around the US and NATO's failures in the region. The catastrophic collapse of Western-mandated nation-building efforts spanning across two decades within a fortnight exposed the hollow nature of government and governance propped up in the country. However, beyond the long-reaching security implications of this reversal, there is a critical need to study the economic implications of the Taliban takeover, especially the multilateral response from global governance institutions.

Even as the Taliban scramble for international legitimacy, the global financial system and multilateral institutions remain poised to ostracize the new Taliban regime. This brief particularly focuses on the prospect of the Financial Action Task Force (FATF) placing Afghanistan on the list of countries subject to "Call for Action" (or the black list), effectively banning participation in the global financial system. The powers of the FATF, including its black listing of other non-cooperative regimes such as the Democratic People's Republic of Korea (DPRK) and Iran, will be assessed in detail. The brief will conclude with possible scenarios panning out in Afghanistan with their implications, as well as actionable recommendations for Pakistan to mitigate any possible fall out.

THE FATF AS THE GATEWAY TO THE GLOBAL FINANCIAL SYSTEM

Powers of the FATF

The Financial Action Task Force (FATF) is a global watchdog that develops policies for curbing money laundering and terrorism financing (ML/TF). The FATF ensures that the world adheres to its standards and guidelines in a bid to protect and preserve the global financial system from ML/TF and proliferation financing (PF) risks. Particularly, the FATF mandates the implementation of UNSC Resolutions 1267 and 1373 – which calls on states to halt and criminalize funding of designated terrorists, amongst other measures.[1]

The FATF conducts peer reviews of each member country on an ongoing basis to assess levels of implementation and provides analyzes of each country's system for preventing criminal abuse of the financial system. Risks emanating from a jurisdiction are calculated, and high-risk countries are subject to additional due diligence measures and checks.

Within this vein, the FATF's role is not limited to facilitating the implementation of standards, but also one of penalizing countries for non-compliance. In its mandate, the FATF resolves to

[1] FATF Ministerial Declaration and Mandate 2019 <https://www.fatf-gafi.org/media/fatf/content/images/FATF-Ministerial-Declaration-Mandate.pdf>

"hold to account jurisdictions" that do not adhere to its standards.[2] This effectively means that the FATF regulates a jurisdiction's participation in the global financial system and the economy.

Non-Cooperative Countries and Jurisdictions subject to Call to Action (the FATF "Blacklist")[3]

In its mandate, the FATF equates protecting the global financial system to contributing to global security. By enabling member countries and jurisdictions to apply the same standards of countering ML/TF and PF, the FATF ensures that the global financial system remains insulated from such risks. The FATF's primary tool of ensuring this remains black listing, and the threat of black listing, which is wielded to achieve its objectives.

Countries that are not up to par in terms of the FATF's standards are subject to further scrutiny and evaluations. The FATF places such countries into two categories – Jurisdictions under Increased Monitoring" (the 'grey list') and "Non-Cooperative Countries and Jurisdictions subject to Call to Action" (the 'black list').[4] Being placed on the 'grey list' has financial implications for a country, including harsher conditions when pursuing international loans and increased overall scrutiny.

On the other hand, countries on the black list are effectively excluded from the global financial system. For such jurisdictions, the FATF calls on all member countries, affiliates and observer bodies (including organizations such as the International Monetary Fund, World Bank, etc.) to take counter-measures to protect the international financial system from ML/TF risks.[5] This implies that all manner of transactions with black listed jurisdictions and even individuals from such jurisdictions are banned, and those found engaged with such jurisdictions would also be subject to similar measures. Currently, the only two jurisdictions placed on the FATF black list are Iran and the Democratic People's Republic of Korea (DPRK, or North Korea).[6]

Profiles of Black listed Countries: Iran and DPRK[7]

To-date, the FATF has not directly black listed a country or jurisdiction. Jurisdictions are first placed under enhanced scrutiny (the grey list), with a high-level political commitment required from the political regimes to engage with the FATF and address the deficiencies in their

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[2] FATF Ministerial Declaration and Mandate 2019 <https://www.fatf-gafi.org/media/fatf/content/images/FATF-Ministerial-Declaration-Mandate.pdf>
[3] FATF List of High-Risk Countries and Jurisdiction Subject to Call to Action <http://www.fatf-gafi.org/countries/d-i/iran/documents/call-for-action-june-2021.html>
[4] FATF Mandate
[5] Counter-measures refer to applying a range of enhanced due diligence and strict reporting mechanisms in transactions with both businesses and individuals from a high-risk jurisdiction. The FATF can also ask countries and jurisdictions to prohibit establishing of branches or correspondent banking relationships with high-risk jurisdictions, subject to call to action.
FATF Methodology: Guidance on Recommendation 19 (Higher Risk Countries) <https://www.cfatf-gafic.org/documents/fatf-40r/385-fatf-recommendation-19-higher-risk-countries>
[6] FATF List of High Risk Countries and Jurisdiction Subject to Call to Action <http://www.fatf-gafi.org/countries/d-i/iran/documents/call-for-action-june-2021.html>
[7] Ibid.

AML/CFT frameworks. Once this commitment is secured, the FATF and its Technical Group, the International Cooperation Review Group (ICRG) work with the countries to create action plans that would allow for the countries to exit the grey list. Such action plans are time-bound; if no progress is registered within an allotted time, the jurisdiction would be demoted to the black list.

This happened in the case of Iran. In June 2016, the FATF placed Iran on the grey list, citing structural deficiencies that led to high proliferation financing risks, potentially jeopardizing the global financial system. Although Iran promptly gave a high-level political commitment to address its strategic deficiencies (coinciding with the signing of the JCPOA deal),[8] it failed to fulfil all the demands of the FATF Action Plan and thus, Iran's action plan expired in January 2018. In October 2019, the FATF called upon its members and urged all jurisdictions to take counter-measures. This included requiring increased supervisory examination for branches and subsidiaries of financial institutions based in Iran, introducing enhanced relevant reporting mechanisms or systematic reporting of financial transactions; and requiring increased external audit requirements for financial groups for any of their branches and subsidiaries located in Iran. In February 2020, the FATF put Iran on its blacklist after Tehran failed to comply with the FATF's AML/CFT standards.[9]

In case where grey listed countries or jurisdictions fail to give a high-level political commitment and do not improve their AML/CFT frameworks, they are then promptly placed on the FATF black list. This was illustrated with the case of North Korea. In February 2010, the FATF put DPRK on the grey list, due to a lack of an effective AML/CFT regime which posed a risk to the international financial system. The FATF critically noted the lack of commitment on part of the North Korean regime to engage on these issues with the FATF, and called on the country to cooperate with FATF authorities. A year later, in February 2011, the FATF issued a call to its members and urged all jurisdictions to apply effective counter-measures and targeted financial sanctions against DPRK banks and other institutions. DPRK has been retained on the black list ever since.

Politicization of the FATF

There is valid concern regarding the politicization of the FATF, including the decision to grey- or black list certain jurisdictions. Like most other global institutions, decisions within FATF are effectively made by a few countries but are binding upon the rest of the world. The FATF comprises of a concert of 39 countries, largely comprising the developed world and other major economies, which form part of the FATF Plenary.

[8] "What Is the Iran Nuclear Deal?" Council on Foreign Relations. https://www.cfr.org/backgrounder/what-iran-nuclear-deal.
[9] "Iran on FATF Blacklist." Financial Tribune. February 21, 2020. <https://financialtribune.com/articles/business-and-markets/102273/iran-on-fatf-blacklist>

Despite promoting itself as a standards-based and technically oriented body, the FATF as a global institution is not entirely insulated from political pressures. The admission of the Indian government in allegedly promoting Pakistan's grey listing as part of achieving a strategic foreign policy objective remains a key example.[10] The black listing of North Korea and Iran – with political regimes incongruent with US interests and already subject to sanctions from the West – too can be construed as an iteration of the FATF's supposed political capture. However, the FATF remains bound by its mandate of promoting global security by protecting the financial system and relies primarily on UN mandates and resolutions – which have a standing in international law. Because of these considerations, as well as the FATF's own stance, the situation in Afghanistan may unfold differently.

FATF & Afghanistan

In June 2012, the FATF placed Afghanistan on the grey list with an action plan to complete as well as enhanced monitoring.[11] Five years later, in June 2017, Afghanistan was removed from the grey list as the FATF recognized Afghanistan's "established legal and regulatory frameworks" as capable of meeting the demands of its action plan.[12]

However, many countries continue to treat Afghanistan as a High-Risk jurisdiction because of the high ML/TF risks emanating from the region. The European Union's Commission's list of AML/CFT and the US State Department retained as a country/jurisdiction of primary concern in respect to Money Laundering and Financial Crimes.[13] Pakistan also identifies key ML/TF risks emanating from Afghanistan in its National Risk Assessment, 2019.[14] Pakistan has additionally passed the Counter-measures for High Risk Jurisdiction Rules, 2020 to adequately apply counter-measures to jurisdictions posing high threats to the country.[15]

In the October 2021 Plenary, the FATF issued a statement about the situation in Afghanistan.[16] While the FATF affirmed UN Security Council Resolution 2593 (2021), it also called on all jurisdictions' competent authorities to liaise with private sectors in assessing and mitigating any emerging ML/TF risks identified and preventing the misuse of NPOs for TF particularly. The body also expressed concern about the "current and evolving ML/TF risk

[10] "US Says It Backs Pakistan's Efforts on FATF Grey List." DAWN.COM. July 21, 2021. <https://www.dawn.com/news/1636257>
[11] Mutual Evaluation of Afghanistan, 2011
<https://www.fatf-gafi.org/publications/mutualevaluations/documents/mutualevaluationofafghanistan.html>
[12] O'Loughlin, Erin. "Financial Intelligence: A Band-Aid for Human Intelligence? - CFCS: Association of Certified Financial Crime Specialists." Certified Financial Crime Specialists.
<https://www.acfcs.org/financial-intelligence-a-band-aid-for-human-intelligence/>
[13] "Anti-money Laundering and Countering the Financing of Terrorism." European Commission - European Commission.
<https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-countering-financing-terrorism_en>
"International Narcotics Control Strategy Report." United States Department of State Bureau of International Narcotics and Law Enforcement Affairs, 2021.
<https://www.state.gov/wp-content/uploads/2021/02/21-00620-INLSR-Vol2_Report-FINAL.pdf>
[14] National Risk Assessment 2019
[15] High Risk Jurisdiction Rules 2020, Financial Monitoring Unit
<https://www.fmu.gov.pk/docs/Counter-measures-for-High-Risk-Jurisdictions-Rules-2020.pdf>
[16] FATF Public Statement on the Situation in Afghanistan, Oct 21, 2021
https://www.fatf-gafi.org/countries/a-c/afghanistan/documents/afghanistan-2021.html

environment in the country,"[17] while emphasizing the need to provide humanitarian assistance to the beleaguered Afghani populace. Finally, the FATF along with regional bodies affirms that it will "closely monitor the situation" in Afghanistan, specifically concerning changing risks in the country while promoting the security of the global financial system.

Tellingly, the FATF did not place any sanctions on and it continues to operate without being subject to any counter-measures. Additionally, the language of the statement illustrates a cautious approach being adopted by the global governance body with regards to Afghanistan while it evaluates the ground situation. It also affirms the recent US' stance on allowing humanitarian assistance to Afghanistan in light of its depreciating situation.[18]

DRIVERS BEHIND AFGHANISTAN'S INCREASED RISK PROFILE

The Taliban takeover poses dire challenges for the global financial system. Firstly, the Taliban remain sanctioned by the United Nations under UNSC Resolutions 1267 and 1988.[19] This is separate from sanctioning of individuals and the organization broadly by the European Union,[20] the United States,[21] the United Kingdom,[22] Australia and other countries.[23] A designated organization, reliant on predicate criminal activity for funding, running a country historically rife with security challenges all substantively elevate Afghanistan's risk profile. Critically, it also raises the risk profile of neighbouring countries such as Pakistan.

In addition to the sanctioned Taliban regime, the US withdrawal has brought on a crippling financial crisis, bringing Afghanistan to the brink of humanitarian disaster. Locally, the general population is rushing to withdraw cash, resulting in "bank runs" that are bleeding the country dry in terms of liquid cash.[24] International donors are blocking funds and shutting off the flow of money. Uncertainty continues to lower confidence, resulting in capital flight and investments being withdrawn from the country. Multilateral organizations such as the International Monetary Fund (IMF) have halted the distribution of more than $400 million in emergency reserves, with the World Bank and other affiliates are following suit. This is critical to note, as foreign aid comprises 44% formal Afghan economy and 75% of public spending - without these inflows,[25] the Afghan economy teeters at the edge of total collapse.

[17] Ibid.
[18] US Announces Additional Humanitarian Assistance for Afghanistan, Express Tribune, Oct 30, 2021 https://tribune.com.pk/story/2327070/us-announces-additional-humanitarian-assistance-for-afghanistan
[19] "They Aren't Listed but Make No Mistake: The UN Has Sanctions on the Taliban." Atlantic Council. August 23, 2021. <https://www.atlanticcouncil.org/blogs/new-atlanticist/they-arent-listed-but-make-no-mistake-the-un-has-sanctions-on-the-taliban/>
[20] European Union (EU) Sanctions Map <https://www.sanctionsmap.eu/#/main/details/1/?search=%7B%22value%22:%22%22,%22searchType%22:%7B%7D%7D>
[21] United States Department of Treasury, Office for Foreign Assets Control (OFAC), Overview of Sanctions Against the Taliban <https://irp.fas.org/threat/t11tali.pdf>
[22] 'Financial Sanctions, Afghanistan' (GOV.UK, 2013) <https://www.gov.uk/government/publications/financial-sanctions-afghanistan>
[23] 'The Taliban Sanctions Regime' (https://www.dfat.gov.au/) <https://www.dfat.gov.au/international-relations/security/sanctions/sanctions-regimes/Pages/the-taliban-sanctions-regime>
[24] 'Afghanistan Faces Economic Shock as Sanctions Replace Foreign Aid' (*Nytimes.com*, 2021) <https://www.nytimes.com/2021/08/21/business/afghanistan-economy.html>
[25] 'Economic Crisis Looms for Afghanistan Under Taliban Rule' (*VOA*, 2021) <https://www.voanews.com/us-afghanistan-troop-withdrawal/economic-crisis-looms-afghanistan-under-taliban-rule>

Apart from multilateral aid suspension, the United States is further limiting Taliban access to US dollars. The US government has blocked the Taliban from accessing international reserves workaround USD 9.4 billion, held at the Afghan central bank, Da Afghanistan Bank (DAB).[26] The US has also halted the physical inflow of US dollars, the *afghani* – with the latter plunging to record lows, citing fears of uncontrolled inflation. All these issues run parallel to the question of sanctions.[27] Imposed by the US, UK and EU further choke finances and inflows, these sanctions are exacerbating the economic situation in Afghanistan. With prices of food and necessary goods soaring and key public services unavailable, a humanitarian crisis looms imminent.

Within this vein, the economic pressures defined above can serve as drivers of the black economy in Afghanistan. Though the Taliban renounced relying on opium trade,[28] a UN report acknowledges that the group previously derived its revenues from criminal activities such as drug trafficking, opium poppy production, extortion, smuggling, kidnapping for ransom and mineral exploitation. Earnings from these practices are between $300 million and $1.6 billion a year, allowing the Taliban to sustain operations even during the US presence in Afghanistan.[29]

These factors, amongst others, are poised to further increase the incidence of predicate crimes, money laundering and terrorism financing. The lack of support from the international community will in particular drive the populace into such professions, potentially resulting in a hike in such criminal practices.

POSSIBLE SCENARIOS FOR AFGHANISTAN

With all these in mind, the following scenarios can unfold in Afghanistan with regards to the FATF:

Scenario 1: <u>Afghanistan grey listed by the FATF</u>

This would be similar to how the FATF treated Iran and DPRK initially. The FATF would then require a high-level political commitment from the Taliban government in improving its AML/CFT frameworks, and would devise an action plan to minimize deficiencies and achieve adherence to the FATF's standards.

[26] 'The Taliban Now Controls the Afghan Economy. Here's What That Means.' (Atlantic Council, 2021) <https://www.atlanticcouncil.org/blogs/new-atlanticist/the-taliban-now-controls-the-afghan-economy-heres-what-that-means/>
[27] Ibid.
[28] Zamir Saar and James Marson Sune Engel Rasmussen, 'WSJ News Exclusive | Taliban Move to Ban Opium Production in Afghanistan' (WSJ, 2021) <https://www.wsj.com/articles/taliban-afghanistan-heroin-ban-opium-production-11630181316>
[29] 'Afghanistan Faces Economic Shock as Sanctions Replace Foreign Aid' (Nytimes.com, 2021) <https://www.nytimes.com/2021/08/21/business/afghanistan-economy.html>

Given the Taliban regime's willingness to achieve international legitimacy, Afghanistan might acquiesce to the FATF's demands in this scenario and cooperate with the FATF and ICRG to achieve the demands of the action plan. Failure to implement the FATF Action Plan within an allotted timeframe could result in potential black listing of Afghanistan.

Scenario 2: Afghanistan grey listed with call for enhanced due diligence

This implies that the FATF would scrutinize Afghanistan while calling on multilateral institutions and other countries to take some degree of action against the regime in the meantime. The nature of these measures would not be as severe as those implemented in black listing, but would entail the undertaking of enhanced due diligence and other similar measures to restrict the funds flowing into Afghanistan. Afghanistan may also be placed in the list of countries.

While this has not been attempted before, it is the most likely option out of the three scenarios. In the FATF's statement on Afghanistan, elements of this approach can be interpreted, with the FATF calling on competent authorities of all jurisdictions to re-evaluate ML/TF risks in line with the private sector. This option also allows FATF to remain true to its mandate of ensuring global security and protecting the international financial system and remains politically feasible without alienating the Taliban regime. It also enables the international community to ascertain the status of the Afghan Taliban, which suffers from a critical lack of clarity that can be exploited by other powers to further geopolitical aims.

Scenario 3: The FATF puts Afghanistan on the black list

In this scenario, the FATF plenary decides to relegate Afghanistan to the FATF blacklist directly – without grey listing it. The rationale behind this decision can be rooted in the implementation of the UNSC Resolutions 1267 and 1373 – which form the bedrock of global CFT regimes and are integral to the discourse of preserving the international financial system. This option would mandate all jurisdictions of the world as well as multilateral organizations to adopt counter-measures against the Taliban regime, effectively ostracizing it from the global economy.

Direct black listing, if it happens, remains without precedent as of now. By directly black listing a country, the FATF would be operating outside of its own character in denying the grey list to Afghanistan. Additionally, due to the COVID-19 pandemic, the FATF has paused the review process for black listed, as that they are already subject to the FATF's call for countermeasures – hence Afghanistan may escape direct blacklisting owing to the pandemic. However, given the extraordinary nature of circumstances, FATF might opt to continue with direct black listing.

IMPLICATIONS AND WAY FORWARD FOR PAKISTAN

Pakistan has been grey listed by the FATF owing to high ML/TF risks emanating from the region. Bordered by a black listed country in the West (Iran), and sharing a long, porous border with another jurisdiction now under the effective control of a designated entity (Afghanistan) is likely to worsen Pakistan's risk profile and exacerbate existing risk ratings. The FATF can use these to further prolong Pakistan's grey listing. The National Risk Assessment 2019 recognizes significant threats arising from Afghanistan, particularly concerning narcotics trade, smuggling, cash couriers, and terrorism financing, amongst others. More coordinated and targeted action is required to mitigate the increased risk emanating from Afghanistan.

However, the situation in Afghanistan grows increasingly dire and the severity of the humanitarian crises unfolding there cannot be ignored. Ostracizing a regime scrambling to afford basic necessities and services for its people will only result in the deepening of the black economy in Afghanistan, and further result in predicate crimes and money laundering. Rather, a balanced approach needs to be adopted, one that honours individual rights and freedoms, as re-iterated in the FATF's statement on Afghanistan as well.

Nevertheless, Pakistan has to prepare for eventualities and increased risks now emanating from Afghanistan. The FATF is now calling on competent authorities of all jurisdictions to re-evaluate risks as well as conduct trainings and dissemination with regards to the changing situation in Afghanistan. Pakistan, in turn, needs to apply a staggered approach. A whole-of-government response, coordinated by the National Executive Committee (NEC), is required to devise guidelines and rules to mitigate the enhanced ML/TF risks with the Taliban takeover. Furthermore, guidelines should also be specifically devised for financial institutions (FIs) as well as law enforcement agencies (LEAs) working on-ground, commensurate with the increased risk. Regulators such as the State Bank of Pakistan (SBP) and the Securities and Exchange Commission of Pakistan (SECP) need to issue guidance to all FIs, including micro-finance banks and exchange companies regarding conducting transactions with Afghanistan. Finally, authorities such as the Financial Monitoring Unit (FMU) and the Federal Board of Revenue (FBR) along with other supervisors and regulators need to conduct extensive training programs to ensure that Designated Non-Financial Businesses and Professions (DNFBPs) conduct EDD with riskier clients.

Given Pakistan's substantive progress, it needs to heed the FATF's words, while also promoting the case of humanitarian assistance to be delivered to the Afghan populace, the majority of whom already suffer from abject poverty and hunger. Coordination with international donors and other relief agencies is essential in the provision of basic necessities such as food, potent water and medicines to the Afghanistan populace. As illustrated by the

FATF, the world needs to continue to develop a more cautious response to the situation in Afghanistan to prevent an acute humanitarian disaster.

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