

Global Anti-Money Laundering Regime and Pakistan

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Abstract

Many researchers point out to the fact that the criminals have been quicker to embrace the 21st century globally economy than the lawmakers. Money laundering, including terrorist financing, has had far-reaching implications for Pakistan. This paper is aimed at finding out what initiatives have been taken by international organizations and corporate governance regimes on Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT). It further takes into account how Pakistan has responded so far in relation to the international requirements. With reference to Pakistan, it also examines what legal, legislative, regulatory, law-enforcement and institutional measures have been taken so far. Alongside, it attempts to evaluate the adequacy and effectiveness of the country's anti-money laundering laws from the perspective of professionals, both from the public and corporate sectors. There is a need of an effective anti-money laundering regime in every country including Pakistan to counter the menace of money laundering which has far-reaching socio-economic consequences.

Keywords

Money Laundering, Terrorist Financing, Corporate Governance Regime, Financial Action Task Force (FATF), Asia Pacific Group (APG), State Bank of Pakistan (SBP), Securities and Exchange Commission of Pakistan (SECP)

Introduction

Money laundering undermines the stability of financial systems and the integrity of markets. It corrupts institutions, government officials and the private sector and challenges the rule of law, economies and national security. It is a global problem.

In Pakistan, money laundering, terrorist financing and corporate financial crimes remain significant. Pakistani criminal networks in collaboration with Afghan drug traffickers are involved in the transshipment of narcotics and smuggling of goods from Afghanistan to international markets. The proceeds of narcotics trafficking and funding for terrorist activities are often laundered by means of the alternative remittance systems called *Hundi* and *Hawala*. These systems are also widely used by Pakistani people for legitimate purposes. Reportedly, a network of some private unregulated charity organizations have also emerged as a significant source of illicit funds for domestic as well as international terrorist networks (Haider, 2014).

Prior to 2010, there was no well-developed law or apparatus in Pakistan to combat money laundering. However, with the promulgation Anti-Money Laundering Act 2010 and establishment of an effective Financial Monitoring Unit

(FMU), the country is now having an effective law to control the crime and put the money launderers and terrorist financiers behind the bars. The issue of money laundering has drawn great attention of the Government of Pakistan. The State Bank of Pakistan (SBP), the central reserve bank of the country and Securities & Exchange Commission of Pakistan (SECP), the state's regulator of the corporate sector, have issued comprehensive standard operating procedures. It includes Prudential Regulations by SBP and "Code of Corporate Governance" by SECP, for regulating banking and non-banking financial institutions to instill fair, transparent, and accountable practices etc (Azeem, 2013).

Purpose of the Study

The purpose of this study is to provide useful analysis of the global Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) regime and that what legal, legislative, regulatory and law enforcement measures have been taken by Pakistan in response to meeting the international requirements and standards. An attempt has been made to assess the legislative development in Pakistan viz a viz money laundering and terrorist financing and to suggest possible measures for their improvement in the light of international laws knowledge gained through empirical research. This exploratory research work serves as a trailblazer for the future researchers to probe the matter further.

Anti-Money Laundering Regulation

Money laundering is a global menace and is deep-rooted in the major industrial economies of the world. As early as in 1970s, the world powers started realizing to curb the deadly combination of the ill-gotten money, its subsequent siphoning off to different destinations world-over. The United Nations sensitized its signatories of the lethal consequences of the money laundering, and encouraged them through Vienna Convention, Palermo Convention and Marida Convention to evolve legal frameworks and find ways and means to counter the same. In 1989, the G-7 (the major industrial economies of the world) joined hands against money laundering and established Financial Action Task Force (FATF). This task force issued forty (40) recommendations to control money laundering and after 9/11 incident, issued nine (9) special recommendations to counter the financing of terrorism.

Financial Action Task Force (FATF)

Since 1989, the FATF has worked to produce a comprehensive set of international standards against money laundering and terrorist financing. The work of the FATF focuses on three principal areas:-

1. Setting bench-marks for national anti-money laundering and counter terrorist financing programs.
2. Assessing the level of implementation of such programs by the participating countries, while complying with those standards.
3. Developing better understanding of the in vogue and novel means and methods being adopted for the purpose of money laundering and terrorist financing methods and trends.

The core documents of the FATF endorsed by every member country and by countries and jurisdictions, who are members of a specific FATF Styled Regional Bodies (FSRBs), comprise:

- a. The Standards - 40 Recommendations on Money Laundering and nine (9) Special Recommendations on Terrorist Financing,
- b. The Methods - Methodology for assessing compliance with the standards,
- c. Notes - Interpretative Notes to the Recommendations, and
- d. Practices - Best Practice Guidelines for implementation of the standards.

The FATF standards contain certain core, or essential, recommendations requiring the member states to:

- Declare money laundering and terrorist financing a criminal offence,
- Freeze terrorist assets and confiscate the proceeds of crime,
- Establish a financial intelligence unit to gather, assess, and circulate suspicious transaction reports from financial institutions and other reporting entities.
- Supervise those financial institutions and other reporting entities to ensure compliance with customer due diligence and other requirements contained in the standards.
- Ensure that comprehensive and effective mechanisms are in place to cooperate effectively on the international level.

These standards globally recognized as policy yardsticks for anti-money laundering and anti-terrorist financing measures by the United Nations, International Monetary Fund (IMF), World Bank, Asian Development Bank and many other international organizations and bodies.

Later on, Asia/Pacific Group (APG), a regional body on money laundering was formed by thirteen (13) member countries, in 1997 in Bangkok. In 2000, Pakistan also joined the group to express its strong commitment towards eliminating the menace of money laundering. Now there are forty one (41) members of the group and a number of international and regional observers.

Asia Pacific Group (APG) on Money Laundering

The Asia/Pacific Group on Money Laundering (APG) is an autonomous and collaborative international organization. Some of the key international organizations who participate, and support the efforts of the APG in the region include the Financial Action Task Force (FATF), International Monetary Fund (IMF), World Bank, Organization for Economic Cooperation and Development (OECD), United Nations Office on Drugs and Crime, Asian Development Bank (ADB) and the Egmont Group of Financial Intelligence Units.

The member and observers of the APG are committed to the effective implementation and enforcement of internationally accepted standards against money laundering and the financing of terrorism, in particular the Forty Recommendations and Nine Special Recommendations on Terrorist Financing of the Financial Action Task Force (FATF) on Money Laundering.

The APG has five key roles: (1) to gauge compliance by APG member jurisdictions with the global AML/CFT standards through a robust mutual evaluations program (2) to synchronize technical assistance and training with donor agencies and countries in the Asia Pacific region in order to improve compliance by APG members with the global AML/CFT standards (3) to contribute in and cooperate with, the international anti-money laundering network – primarily with the FATF and with other regional anti-money laundering groups, (4) to conduct research and analysis into money laundering and terrorist financing trends and methods to better inform APG member of systemic and other associated risks and vulnerabilities, and (5) to contribute to the global policy development of anti-money laundering and counter terrorism financing standards by active Associate Membership status in the FATF.

Besides the above role, APG also provides technical aid to its members and jurisdictions to establish coordinated domestic systems for reporting and investigating suspicious transaction reports and for imparting professional training to build capacities to examine and put on trial, criminals and entities caught in money laundering and the financing of terrorism offences.

Other International Sources of Ensuring Compliance of AML/CFT Standards

i IMF and World Bank

While granting financial assistance, the International Monetary Fund (IMF) and the World Bank (WB) make it conditional to the recipient countries to put in place effective money laundering controls, while endorsing the FATF 40 + 9 standards as the relevant standards for AML and CFT (Duhaime, 2014).

The IMF and the WB, usually conduct the Financial Sector Assessment Program (FSAP), designed to assess the strengths and weaknesses of a country's financial sector. The two donor agencies, in consultation with the FATF have developed a single global methodology for evaluating the compliance status of the FATF recommendations by the borrowing countries. Such a methodology is an integral part of the FSAP for clearing the country before approving the financial assistance. Detailed assessments of observance of relevant financial sector standards and code, which give rise to Reports on Observance of Standards and Codes (ROSC) are a key component of the FSAP (Matonis, 2013).

There are 12 recognised areas and associated standards used to guide the operational work of the IMF and WB comprising: accounting; auditing; AML/CFT; banking supervision; corporate governance; data dissemination; fiscal transparency; insolvency and creditor rights; insurance supervision; monetary and financial policy transparency; payments systems; and securities regulation.

ii. The Egmont Group

In 1995 at the Egmont Arenberg Palace in Brussels, a group of Financial Intelligence Units (FIUs), decided to establish an informal group for the stimulation of international co-operation. Now known as the, these FIUs meet regularly to find ways to cooperate, especially in the areas of information exchange, training and the sharing of expertise.

The prime objective of the group is to build a strong international platform of FIUs by promoting international co-operation and co-working. The group provides a forum for FIUs around the world to improve support to their respective governments to combat money laundering, terrorist financing and other financial crimes.

iii. The Basel Committee on Banking Supervision -1974

As the name suggests, the committee is focused on the core banking sector, primarily for setting globally acceptable norms and standards for banking regulations and supervision. The committee has a strong sentiments for combating the menace of money laundering and it has introduced the following three sets of principles and guidelines.

- a. Statement of Principles on Money Laundering -1988
- b. Core Principles on Banking Supervision (CP-15)-1997
- c. Customer Due Diligence –2001

iv. Offshore Group of Banking Supervisors (OGBS) – 1980

This group was formed on the prompting of the Basel Committee on Banking Supervision. The group has 18 member states and 2 observers. Basically, it is an association of the authorities engaged in “offshore finance centers”.

v) Wolfsberg Group of Banks – 2000

This is a Swiss-based association of eleven (11) banks, and also include representatives from Transparency international (TI), academic professionals.

Pakistan And Anti Money Laundering Regime

Primary Financial Regulators in Pakistan

Pakistan being member of APG and UN is obliged to comply with FATF Recommendations. The State Bank of Pakistan (SBP) is the primary regulator for Banks and DFIs in Pakistan while the Securities & Exchange Commission of Pakistan (SECP) is responsible for regulating the non-banking financial sector. The regulatory measures are updated from time to time by both the regulators.

Regulatory Measures by SBP

Being regulator of banks and DFIs, State Bank of Pakistan is fully cognizant of its role in ensuring clean and transparent banking system in the country. Toward this end, requirement of determining the true identity of prospective account holders was imposed by the State Bank as far back as 1992. This was in addition to, prudential regulation on prevention of criminal use of banking channels for the purpose of money laundering and other unlawful trades. The regulatory regime continued to evolve and strengthened in the light of changes and developments in the financial market and international best practices. During the process, State Bank has taken following steps to curb and control money laundering:

1. Issuance of Prudential Regulations

The basic element for financial institutions to counter money laundering is to evolve a risk based system with an effective risk management framework which mainly includes: know your customer (KYC), account monitoring, record retention, due diligence in correspondent banking relationship and reporting of suspicious transactions. Though Banking Regulations were in vogue since long, a comprehensive set of Prudential Regulations was enforced in June, 2004 and updated from time to time. These Prudential Regulations

contain Know Your Customer, Anti-Money Laundering Measures, Record keeping, Correspondent Banking Relationship, Reporting of Suspicious Transactions, appointment of Compliance Officer. Implementation of these regulations is ensured through on-site examination and off-site surveillance. Officers of Inspection Department specifically verify the adequacy of KYC policies and other Anti-Money Laundering safeguards during their on-site inspections. Inspection of banks/DFIs is conducted on periodic as well as on need basis. The inspection report is shared with Banking Supervision Department for enforcement action. Banking Supervision Department takes action against banks/DFIs who are found deficient in compliance of regulations and other remedial measures are also taken to ensure compliance in future.

2. Guidelines on Internal Controls

Internal controls go a long way in preventing financial crimes in the financial institutions. As a part of its ongoing efforts to encourage banks/DFIs to adopt robust risk management practices, the State Bank of Pakistan has prepared detailed Guidelines on Internal Controls. The guidelines were circulated amongst banks in May 2004. These guidelines require all banks/DFIs to ensure existence of an effective system of internal controls, which is commensurate with the nature, size and complexity of their business; minimizes the risk inherent in their activities; and responds to changes in the business and general economic environment in which the banks/DFIs operate.

3. Anti Money Laundering Guidelines

As a matter of fact, financial institutions have not been able to fully implement the controls. Effective implementation of these controls is crucial for blocking funding for criminals, most significantly terrorists. Strong controls against the laundering of ill-gotten money are considered a big help in detecting corruption and preventing financial and tax frauds. Pakistan has benefitted from the reduction in the transfer of money from its overseas workers through the informal channels of *hawala/hundi*. There has been a phenomenal increase in remittances through formal channels. The fresh SBP guidelines prohibit the use of personal accounts for charity or the collection of donations and require financial institutions to review their relationship with NGOs and charities. Financial institutions conduct comprehensive due diligence of organizations and individuals authorized to operate their accounts before establishing a relationship with them as the first line of defense against money laundering and to ensure that there are no linkages of the charities with the banned groups and that the use of funds is not for illegal purposes.

4. Formation of Exchange Companies

Through an amendment in Foreign Exchange Regulation Act, 1947, money changers have been replaced with Exchange Companies. These companies are subject to proper monitoring and on-site inspection by SBP. With the powers to conduct on-site inspection of such companies, State Bank can keep an eye on their activities. Banks/DFIs and Exchange Companies are encouraged to provide competing services in the formal sector in order to remove any incentives being provided by *Hawala* operators.

5. Policy for Discouraging use of Alternate Remittance System (ARS)

The SBP's regulatory measures of licensing the Exchange Companies to undertake the business of sale/purchase of foreign currencies, transfer of funds in a legitimate manner has helped in switching remittances from *Hawala/Hundi* operators to the Exchange Companies which are monitored/supervised regularly by the State Bank of Pakistan. However, to eliminate illegal networks of *Hawala/Hundi*, coordination and cooperation between law enforcing agencies is required across jurisdictions on an ongoing basis.

Regulatory Measures by SECP

The Commission has taken a number of measures to regulate sectors under its supervisory control as under:

Non Banking Finance Companies and Notified Entities Regulations, 2007/Directions to NBFCs

SECP made the Non Banking Finance companies (NBFCs) and Notified Entities Regulations, 2007 to enable NBFCs to safeguard themselves against money laundering activities and other unlawful trades. In terms of these regulations, NBFCs were directed to ensure compliance of Know Your Customer and CDD system, determine the true identity of their customers, ensure bonafide of remitters and beneficiaries of transactions, retain record of transactions for future reference, put in place effective internal audit and internal control system. These regulations shall be applicable to NBFCs carrying out leasing, investment finance services, housing finance services, asset management services, discounting services, investment advisory services and venture capital investment.

SECP Guidelines to NBFCs on AML/CFT Issued in April 2009

In order to protect NBFCs against involvement in money laundering activities, terrorist financing and other illegal trades, SECP has issued instructions related to Customer Due Diligence (CDD)/Know Your Customer (KYC). NBFCs are

required to formulate a comprehensive Customer Due diligence (CDD)/Know Your Customer (KYC) policy duly approved by their Board of Directors. Besides, CDD and KYC the said circular contains the guidelines on obtaining minimum set of documents from various types of customers, categorization of customers (Low/High risk), customers record updation and retention, etc and ownership of all accounts and those using safe custody facilities. Effective procedures have been instituted for obtaining identification from new customers and an explicit policy has been devised to ensure that significant business transactions are not conducted with customers who fail to provide evidence of their identity. To discourage cash transactions *Modarabas* were directed to ensure that no payment or receipt exceeding Rs.50,000/- be made in cash. A standardized account opening form for purchase of certificates of *Musharikawas* introduced in 2004 by the Modaraba Association of Pakistan (MAP) at the behest of the SECP in line with the recommendations of 'Know Your Customer' (KYC) policies & procedures.

Regulations for Stock Exchanges and Securities Companies/Brokers:

1. Know your Customer Regulations

SECP has applied 'know your customer' regulations to stock exchanges, securities brokers and dealers, trusts and other non-bank financial institutions.

2. Standardized Account Opening Form

SECP had formulated a Standardized Account Opening Form which is being followed by the stock exchanges since January 15, 2004. The introduction of Standardized Account Opening Form, aims at discouraging money laundering through the stock market by focusing on 'know your customer' principle and ensuring related documentation. It will foster greater market transparency and investor confidence as well as ensure adequate disclosure/documentation of information.

3. Introduction of UIN and Mandatory use of Client Codes by Brokers

SECP has made it mandatory for the brokers to enter client code at the time of entering order into the trading engine with effect from June 05, 2006 thus providing a mechanism to counter money laundering through this channel. Further, SECP has introduced Unique Identification Number (UIN) at the three stock exchanges for clients with effect from August 01, 2006 that will result in more transparent market with increased investor protection.

Conclusion and Recommendations

Money laundering and corporate financial crimes have quite significant effects and socio-economic consequences. Money laundering coupled with weak corporate governance regime weaken the financial system and poses serious challenges for the

economies of the world. Good corporate governance, effective legislation and an effective anti-money laundering regime are essential to uphold the integrity of the financial institutions as they lower the pervasiveness of money laundering.

Strong governance regime and fair management practices are essence of all aspects of socio-economic life of a society. If cardinal principles of good governance and fair management practices are compromised, breach of trust becomes a norm that poses serious threat to the sanctity of administrative as well as moral values. As a result, people lose confidence in state institutions. This erodes relationship between state and subjects. In such a state of affairs, people cease to believe in claims of good governance and the rule of law. Poor governance has always been a serious problem of the Pakistani society since its inception. It deprived the people to articulate their interests, exercise their rights, meet their obligations and mediate their differences. Resultantly, moral bond between state, society, government and the people weakened. Bad governance promoted preferential treatment to the privileged class and victimized the less privileged. It promoted absence of predictability, absence of rule of law and lack of equal protection and equality before the law. It also promoted corruption among both perpetrators and the victims who tend to accommodate each other for mutual gains. Thus bad governance and corruption in our society complemented each other and the crime became rewarding. This combination of bad governance and corruption promoted a vicious circle in which corruption is continuing to weaken the legal, administrative and social institutions. Likewise, due to poor, ineffective and weak corporate regime and absence of rule of law, money laundering and terrorist financing activities increased in the country over the period of time.

Money laundering is an international problem. A number of legal, regulatory and law enforcement measures have been taken by Pakistan to combat money laundering and counter the financing of terrorism. However, it has not so far been able to have an effective anti-money laundering and corporate governance regime. Enactment of Anti-Money Laundering (AML) Act 2010 was a landmark event in the chequered AML/CFT legislative history of Pakistan. However, even in the presence of such important laws and various regulatory bodies, the country's economy suffers from colossal losses due to non-implementation of laws and absence of an effective anti-money laundering and corporate governance regime.

State Bank of Pakistan (SBP) and Securities and Exchange Commission of Pakistan (SECP) being the primary financial regulators have taken concrete steps to prevent money laundering and put in place an effective anti-money laundering and corporate governance regime. Both SBP and SECP have been endeavoring to strengthen their capacity in investigating financial crimes, provide and promote education on preventing money laundering and create awareness among the key stakeholders to develop understanding of the main perspectives and framework of anti-money laundering laws.

It is extremely important to understand and recognize how money laundering has adversely been affecting our national economy and national security as money laundering is believed to have a close nexus with terrorist financing. Pakistan needs to be extremely vigilant about the twin menace of money laundering and terrorist financing and efforts be made to have an effective AML/CFT regime. Besides, our laws are also required to be updated in line with the international standards and good corporate is therefore, essential in this regard.

Empirical causes of organized crime of money laundering and weak corporate governance regime in the country have been stipulated in the previous chapter. Empirical evidence suggests that these causes are the symptoms of a society that is dysfunctional in many respects. There is a dire need for a social change that should inculcate change of attitudes and approaches that must internalize such social value system that recognizes criminal behavior is intolerable and unacceptable and that rule of law is the essence for social cohesion and national solidarity.

In order to eradicate the symptoms of money laundering in particular and organized crime in general, a set of measures are necessary to be undertaken. Such measures must be adopted as multi-pronged public social policy to deal with the problem. It is however emphasized that bringing social change and inculcating positive and pragmatic values is time consuming and will require decades to realize the goals. Following are some of the measures to control money laundering, terrorist financing and how to have an effective anti-money laundering and corporate governance regime in the country. It is highlighted that these recommendations are not exhaustive and are essentially complimentary to each other:

- It is the need of the hour that all the countries of the world must criminalize money laundering and terrorist financing and effective legislation be carried out in this regard.
- Anti-Money Laundering Act 2010 of Pakistan is a comprehensive law to deal with the twin menace of money laundering and terrorist financing. All that is essentially required is to enforce and implement the law in real sense of the word and true letter and spirit.
- Efforts are required to be made to meet the standards of Financial Action Task Force (FATF), Asia Pacific Group (APG) on money laundering, The Egmont Group and several other regional and international bodies and various UN resolutions and Conventions dealing with the issue of money laundering and terrorist financing.
- Money Exchange Companies are required to be regulated and controlled in a befitting manner in order to restrict illegal transfer of money through Hundi/Hawala.

- Financial Monitoring Unit (FMU) which performs the typical functions of Financial Intelligence Unit (FIU) is required to be made more powerful and more autonomous. Besides, it is provided with a strong IT structure in order to effectively perform its core functions of collection, analysis and dissemination of Suspicious Transaction Reports (STRs). Regulatory, institutional and supervisory capacity of FMU is also required to be enhanced.
- Ministry of Social Welfare is required to control the suspicious charities more effectively to ensure that these charities are not the front organizations of terrorists or terrorist organizations.
- Enhanced customer due diligence and improved Know Your Customer (KYC) policies on part of State Bank of Pakistan (SBP) and Securities and Exchange Commission of Pakistan (SECP) are required to be adopted.

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Annex I

Time-line of Global Anti-Money Laundering Regime and Pakistan: Key Measures and Initiatives

Year	International Level	Europe	USA	Pakistan	Private Sector
1970			Bank Secrecy Act		
1974	The Basel Committee on Banking Supervision				
1980	Offshore Group of Banking Supervisors	Council of Europe: Measures Against the Transfer and Safekeeping of Funds of Criminal Origin			
1986		UK: Drug Trafficking Offences Act	Money Laundering Control Act		
1988	UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Conventions)				
1989	Financial Action Task Force – FATF				
1990	FATF Recommendations; Caribbean FATF				
1991		European Commission: First Money Laundering Directive			
1995	Egmont Group of Financial Intelligence Units	Europol			
1996	Revised FATF Recommendations				
1997	OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions APG			Anti-Terrorist Act NAB Ordinance Control of Narcotics Substance Act	
1998	OECD Report on Harmful Tax Practices				
1999	Eastern and Southern Africa Anti-Money Laundering Group UN Security Council Resolutions – (1267) International Convention for the Suppression of the Financing of Terrorism IMF/WB – Financial Sector Assessment Program (FSAP)				

Year	International Level	Europe	USA	Pakistan	Private Sector
2000	FATF: List of Non-Cooperative Territories; OECD List of Tax Havens with Harmful tax Practices; Regional Anti-Money Laundering Task Force, Latin America; UN Convention Against Transnational Organized Crime (Palermo Convention) UN Security Council Resolutions – (1333)				Wolfsberg Group of Banks
2001	FATF Special Recommendations on Combating the Financing of Terrorism; Basel Committee: Customer Due Diligence UN Security Council Resolutions – (1373)	European Commission: Second Money Laundering Directive	US Patriot Act, Title III: International Money Laundering Abatement and Anti-terrorist Financing Act		
2002	FATF/IMF/World Bank Agreement on Anti-Money Laundering Pilot Project UN Security Council Resolution – (1390)	Europol mandate expanded; UK: Proceeds of Crime Act			Wolfsberg Principles on Combating Terrorist Financing
2003	Revised FATF Recommendations; UN Convention Against Corruption UN Security Council Resolution – (1455)				
2004	IMF/World Bank include FATF standards to their financial Sector Assessment Programs; Eurasia Group; North Africa and Middle East Group				
2005	UN Security Council Resolutions 1617 & 1624	European Commission: Third Money Laundering Directive		Anti-Money Laundering Bill	
2006			Patriot Act Renewed		International Association of Money Transfer Networks
2007				AML Ordinance Establishment of FMU	
2009				AML Ordinance Revised/ Amended AML Ordinance	
2010				AML Act	
2012				Anti Terrorism Amendment Bill	

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