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Dodging the FATF's blacklist

Stockbrokers are like sharks that can smell blood from afar. And most prominent of them are comforting their foreign and high-net-worth individual clients that Pakistan will emerge unscathed from the Financial Action Task Force (FATF) review due this week. They must have good reason for their optimism.

The market is not totally able to shake off the fear of the FATF's blacklist. Yet investors are increasingly putting money on the table for deeply discounted Pakistani stocks, which shows that greed sometimes overtakes fear.

The market has continued its winning streak for over 24 trading sessions, posting stellar gains of 3,540 points or 11.6 per cent in the benchmark index, which closed on Friday at 34,475 points.

'Blacklisting would result in an overall downgrade of the entire financial system'

So what makes the market so certain that there is no lurking danger from the FATF review? A business tycoon who was part of the group of industry leaders that met the army chief on Oct 2 says that the FATF issue did come up during the discussion.

"Gen Bajwa told the participants he was confident that Pakistan would stave off the blacklist and be shifted from the current 'grey' to the normal category in the next review," the businessman told this writer requesting anonymity.

Secondly, Pakistan has called upon the task force for a "fair and unbiased" evaluation of its progress towards compliance in the face of India's malicious campaign. Indian Defence Minister Rajnath Singh recently demanded that Pakistan be shifted to the FATF's blacklist for alleged terror financing. But a person in the know of things believed that the Indian effort would be foiled. All that Pakistan needs is a minimum of three votes to avoid the blacklist. "Our all-weather friend China, along with Malaysia and Turkey, has already assured us of its support at the upcoming FATF meeting," he said.

Pakistan has indeed come a long way in terms of compliance with FATF requirements. The Asia Pacific Group (APG) on Money Laundering released its mutual evaluation report on Oct 2. It discussed measures that were in place in Pakistan during the onsite visit conducted in October 2018. The APG is a regional body of the FATF, which requires its members to undergo mutual evaluation of the anti-money laundering and combating the financing of terrorism (AML/CFT) frameworks.

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"According to the APG report, out of the 40 recommendations given to Pakistan, the country has shown compliance in one (area), Financial Institutions Secrecy Law, and has shown noncompliance in four areas," stated brokerage firm Topline Securities in its report.

“However, Pakistan is partially compliant on 26 and largely compliant on nine recommendations,” it added.

It mentioned that Pakistan has shown decent progress since October 2018. The National Assembly recently passed a bill to amend Foreign Exchange Regulations (FERA 1947) with a view to streamline the foreign exchange movement and prescribe stricter punishment for money laundering. The government has also launched a crackdown on banned terrorist outfits.

Recently, Pakistan established an operation, coordination and cooperation mechanism for the countering of terror financing. The State Bank of Pakistan (SBP) is playing its role and has penalised local banks in this regard.

A knowledgeable stockbroker said the International Monetary Fund (IMF) had kept the FATF issue as a structural benchmark. Pakistan’s AML/CFT is supposed to be strengthened by the end of this month. “The IMF’s resident representative for Pakistan recently endorsed the country’s efforts to ensure compliance with FATF recommendations,” he claimed.

It may be instructive to remember that the slip into the blacklist has many dangers. But that is the worst-case scenario and, if this market stalwart is to be believed, Pakistan has been in and out of it before. But it attracted less publicity and media commentary then. “The potential impact of being blacklisted by the FATF would be an overall downgrade of the financial system and restrictions on its markets,” Topline Securities cautioned.

Other unsavoury consequences of being blacklisted include difficulties for international banks to operate in Pakistan as the country’s financial system would be declared less transparent. Trading volumes may also see some decline as partner international banks would tighten their policies owing to the financial system that would be under the scrutiny of international agencies.

The push into the blacklist may have a limited impact on Pakistan’s banks as income from international trade constitutes on average only 3pc of total revenues. On the repayment side, the country could manage to secure financial support from friendly countries like China and Saudi Arabia to counter any stoppage of flows from multilateral/bilateral partners.

Another bad consequence would be an increase in the country risk premium, which would result in a higher required return by foreign investors. Interest rates on international loans taken by Pakistan might see an upward revision. Above all, blacklisting would mean that trade agreements of Pakistan might also be in jeopardy as part of non-tariff barriers.

That would be negative for the whole economy as it would hurt exports. That is the last thing that the country could afford as it already is embroiled in a fight to find a firm foothold in foreign markets.