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Inclusion on 'grey list' credit negative for banks: Moody's

ISLAMABAD: Pakistan's continued presence on list of jurisdictions (grey list) under increased monitoring is credit negative for its banks, as it raises questions about potential additional restrictions relating to banks' foreign-currency clearing services, as well as their foreign operations, says Moody's Investors Service.

Moody's in its latest report on Pakistan stated that on 21 February, the Financial Action Task Force (FATF), an inter-governmental body tasked with setting global framework requirements around anti-money-laundering, counterterrorist financing and other related threats to the international financial system, announced that Pakistan (B3 stable) would remain on its list of jurisdictions under increased monitoring, along with 17 other countries, after failing to complete a June 2018 action plan by the assigned deadlines.

Pakistan, which has been presenting its progress to FATF every four months since the agreement of the action plan, will remain on the list until at least June 2020, when the next evaluation will take place.

The announcement is credit negative for Pakistani banks because it raises questions about potential additional restrictions relating to banks' foreign-currency clearing services, as well as their foreign operations, maintained the report. Banks' profitability risks being constrained as a result of increased compliance and operational costs.

According to the report, the FATF has warned that it will urge member countries to increase their attention when conducting business transactions with Pakistan if the country's government, regulatory body and other stakeholders of the financial system fail to complete the action plan, which emphasizes combating terrorist financing, by June 2020.

"Should they fail to do so, international financial institutions could curtail their interactions with Pakistani banks and other financial companies, including terminating correspondent banking relationships. This in turn would further constrain banks' ability to generate business and result in higher compliance costs," stated Moody's.

Improving, but still-weak, compliance with global anti-money-laundering and combating terrorist financing standards, both by Pakistani banks and the country's authorities, means that banks still risk losing access to foreign-currency clearing services.

Access to foreign-currency clearing transactions, typically conducted through international correspondent banking relationships, is crucial for Pakistani banks because it allows them to process cross-border payments for clients.

Clearing in US dollars is particularly important given Pakistan's high import and export economic activity, as well as the fact that a large proportion of international payments are made in this currency. That said this risk has so far not crystallized in the jurisdictions that have been placed on the increased monitoring list.