

The Role of Financial Institutions in Preventing Money Laundering: A Study of Pakistan's AML/CFT Regime

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ABSTRACT

This study examines the pivotal role of financial institutions in preventing money laundering within Pakistan's Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) regime. Anchored in the Anti-Money Laundering Act, 2010 (as amended), and reinforced by regulations from the State Bank of Pakistan (SBP), financial institutions primarily banks and development finance institutions serve as the first line of defense through mandatory customer due diligence (CDD), enhanced due diligence for high-risk customers, ongoing transaction monitoring, and timely reporting of suspicious transactions to the Financial Monitoring Unit (FMU). The research analyzes the evolution of Pakistan's framework, including the establishment of the National AML/CFT Authority and alignment with Financial Action Task Force (FATF) standards following Pakistan's removal from the FATF Grey List in 2022. Despite significant legislative and institutional progress, challenges persist, such as implementation gaps, resource constraints in smaller institutions, and emerging risks from digital financial services. The paper evaluates the effectiveness of risk-based approaches adopted by SBP-regulated entities and highlights the contributions of financial institutions in disrupting illicit financial flows linked to predicate offenses and terrorist financing. Findings underscore the need for sustained capacity building, technological integration, and inter-agency coordination to strengthen preventive measures. This analysis contributes to understanding how regulated financial gatekeepers can bolster national and global financial integrity in a developing economy context.

Keywords: Money Laundering, AML/CFT, Financial Institutions, Pakistan, FATF Compliance.

INTRODUCTION

Background of the Study

Money laundering and the financing of terrorism represent some of the most serious threats to the integrity of the global financial system. These illicit activities enable criminals to disguise the proceeds of drug trafficking, corruption, human smuggling, tax evasion, fraud, and organized crime, while terrorist financing sustains networks that threaten national and international security. Financial institutions banks, development finance institutions, microfinance banks, payment service providers, and other designated non-financial businesses and professions occupy a unique position as gatekeepers of the formal financial

system. Through their routine handling of deposits, transfers, loans, and payments, they are often the first point of contact with illicit funds entering the legitimate economy (Azhar et al., 2025).

In Pakistan, the fight against money laundering and terrorist financing has evolved significantly over the past two decades. The country established its foundational legal framework with the Anti-Money Laundering Ordinance in 2007, later replaced by the Anti-Money Laundering Act, 2010, which has undergone multiple amendments to strengthen compliance requirements and align with international expectations. The State Bank of Pakistan (SBP), as the primary regulator of the banking sector, has issued detailed regulations on customer due diligence (CDD), enhanced due diligence (EDD), record-keeping, suspicious transaction reporting, and risk-based supervision. The Financial Monitoring Unit (FMU), Pakistan's financial intelligence unit, serves as the central agency for receiving, analyzing, and disseminating suspicious transaction reports (STRs) and currency transaction reports (CTRs) (Asghar, Bhatti, & Adnan, 2022).

Pakistan's journey on the international stage has been marked by periods of scrutiny and progress. The country was placed on the Financial Action Task Force (FATF) Grey List in 2012, removed in 2015, re-listed in 2018 due to strategic deficiencies in its AML/CFT regime, and successfully exited the Grey List in October 2022 after completing its action plan. This achievement required substantial reforms, including criminalizing terrorist financing more comprehensively, improving the use of financial intelligence, enhancing investigations and prosecutions, and demonstrating effective supervision of financial institutions. Despite these advancements, the regime continues to face challenges posed by a large informal economy, rapid growth of digital financial services, cross-border cash movements, and the persistent threat of terrorist financing linked to regional instability. Financial institutions remain central to prevention efforts, as they implement risk-based approaches, monitor transactions in real time, and report suspicious activities that feed into the national and international AML/CFT architecture (Ali et al., 2024).

Significance of the Study

The role of financial institutions in preventing money laundering and terrorist financing is critical not only for compliance with domestic law but also for safeguarding Pakistan's economic stability, international reputation, and access to global financial markets. Weaknesses in AML/CFT controls within the banking sector can facilitate the laundering of proceeds from corruption, narcotics trafficking, and other serious crimes, erode public confidence in the financial system, deter foreign investment, and increase the cost of doing business internationally. Conversely, robust preventive measures by banks and other institutions disrupt illicit financial flows, support law enforcement in tracing criminal networks, and contribute to global efforts to combat terrorism and organized crime (M. U. Zafar, Asghar, et al., 2024).

For Pakistan, effective implementation by financial institutions carries heightened importance. The country's strategic location, significant remittances inflow (among the highest globally), growing digital payment ecosystem, and historical exposure to terrorist financing risks amplify the potential consequences of any systemic vulnerability. Strong AML/CFT performance helps maintain correspondent banking relationships, reduces de-risking pressures from international banks, and supports continued integration into the global financial system. Moreover, as Pakistan transitions toward greater financial inclusion through branchless banking, mobile wallets, and fintech innovations, the preventive responsibilities of financial institutions expand to cover new channels of potential abuse (Ashraf et al., 2024).

This study is significant because it focuses specifically on the operational and regulatory realities faced by financial institutions in Pakistan, rather than solely on legislative or policy design. By examining how banks and other entities translate AML/CFT obligations into daily practice through risk assessment, customer onboarding, transaction monitoring, staff training, and reporting it provides insights into

implementation gaps, resource constraints, and practical challenges that often receive less attention than high-level legal reforms. The findings can inform targeted improvements in supervision, capacity building, and technological adoption, ultimately strengthening the preventive layer of the national AML/CFT regime and contributing to more effective disruption of illicit finance (Ahmad et al., 2025).

Research Objectives

- i. To examine the legal and regulatory framework governing the role of financial institutions in Pakistan's AML/CFT regime.
- ii. To analyze the risk-based preventive measures, including customer due diligence, transaction monitoring, and suspicious transaction reporting, implemented by banks and other regulated entities.
- iii. To evaluate the effectiveness of State Bank of Pakistan supervision and guidance in ensuring compliance by financial institutions.
- iv. To identify key challenges, operational constraints, and emerging risks faced by financial institutions in fulfilling their AML/CFT obligations.
- v. To propose practical recommendations for enhancing the preventive role of financial institutions within Pakistan's evolving AML/CFT architecture.

LITERATURE REVIEW

International AML/CFT Standards

The global fight against money laundering and terrorist financing is anchored in standards developed and promoted by the Financial Action Task Force (FATF), an inter-governmental body established in 1989. The FATF's Forty Recommendations, last revised in 2012 and updated periodically, constitute the international benchmark for effective anti-money laundering and countering the financing of terrorism (AML/CFT) regimes. These recommendations adopt a risk-based approach, requiring countries to identify, assess, and understand their money laundering and terrorist financing risks, and to allocate resources accordingly. Recommendation 1 emphasizes risk assessment at national and institutional levels, while Recommendation 10 mandates customer due diligence (CDD) measures, including identification and verification of customers and beneficial owners, and ongoing monitoring of business relationships. Enhanced due diligence (EDD) is required for high-risk scenarios, such as politically exposed persons (PEPs), correspondent banking, and transactions involving high-risk countries (Asghar, Shami, & Kiran, 2025).

Financial institutions are explicitly designated as key gatekeepers under Recommendation 9 (now integrated into broader preventive measures), with obligations to report suspicious transactions promptly to a financial intelligence unit (FIU). Recommendation 16 addresses wire transfers, requiring originator and beneficiary information to accompany cross-border payments to enable tracing. The FATF also stresses the importance of internal controls, compliance programs, staff training, and independent audits within financial institutions (Recommendation 18), as well as protections for reporting entities and their staff against liability when fulfilling obligations in good faith (Recommendation 21). Beyond the Forty Recommendations, the FATF issues interpretive guidance, best practice papers, and mutual evaluation reports that assess country compliance through a rigorous peer-review process (Shami, Asghar, et al., 2025).

The FATF's methodology for assessing technical compliance and effectiveness has evolved to place greater emphasis on outcomes whether a country's measures actually disrupt illicit flows rather than solely on legal frameworks. Countries identified with strategic deficiencies are placed on the so-called "Grey List" or "Black List," facing increased scrutiny, enhanced due diligence requirements from other jurisdictions, and potential de-risking by international banks. These international standards have

influenced regional bodies, such as the Asia/Pacific Group on Money Laundering (APG), which conducts mutual evaluations in the region, and have been incorporated into supranational frameworks like the European Union's AML Directives. The standards recognize that financial institutions, as the primary entry points for illicit funds into the formal economy, bear disproportionate preventive responsibilities, yet they also acknowledge the need for proportionality to avoid overburdening legitimate business or excluding vulnerable populations from financial services (Asghar & Bhatti, 2024).

Pakistan's AML/CFT Framework

Pakistan's AML/CFT regime has undergone substantial transformation in response to domestic threats and international pressure. The foundational legislation, the Anti-Money Laundering Act, 2010, replaced earlier ordinances and established a comprehensive framework criminalizing money laundering, defining predicate offenses expansively, and creating the Financial Monitoring Unit (FMU) as the national FIU. Over the years, the Act has been amended multiple times most notably in 2020 to align more closely with FATF standards, strengthen the criminalization of terrorist financing, expand the scope of reporting entities, and enhance investigative and prosecutorial powers (Kanwel et al., 2024).

The State Bank of Pakistan (SBP) serves as the primary regulator for banks, development finance institutions, microfinance banks, and payment system operators, issuing detailed regulations on AML/CFT obligations. These include risk-based CDD, EDD for high-risk customers, record retention for at least five years, internal compliance programs, and mandatory reporting of suspicious transaction reports (STRs) and currency transaction reports (CTRs) to the FMU. The Securities and Exchange Commission of Pakistan (SECP) regulates non-banking financial companies, while provincial authorities oversee designated non-financial businesses and professions (DNFBPs). Pakistan's placement on the FATF Grey List in 2018 prompted accelerated reforms, including the establishment of a National AML/CFT Authority to coordinate policy, the adoption of a national risk assessment process, and improvements in the use of financial intelligence for investigations and prosecutions (Manzoor et al., 2024).

The country's successful completion of its FATF action plan in 2022 led to removal from the Grey List, reflecting progress in criminalizing terrorist financing, demonstrating effective supervision of financial institutions, and increasing convictions for money laundering and terrorist financing. Despite these achievements, the regime continues to grapple with challenges arising from a large informal economy, significant cash-based transactions, rapid expansion of digital financial services, and the need for sustained capacity building across regulators, reporting entities, and law enforcement (Adnan & Asghar, 2024).

Financial Institutions' Responsibilities

Financial institutions in Pakistan, particularly banks, are positioned as the frontline of defense against money laundering and terrorist financing. Their core responsibilities revolve around implementing a risk-based approach that begins with institutional risk assessments to identify vulnerabilities specific to their customer base, products, services, delivery channels, and geographic exposure. Customer due diligence obligations require identification and verification of customers and beneficial owners at onboarding, with simplified due diligence permitted only for low-risk scenarios and enhanced measures applied to high-risk cases, including PEPs, non-resident customers, and transactions involving high-risk jurisdictions (Shami, Ashraf, et al., 2025).

Ongoing monitoring of business relationships and transactions is mandated to detect unusual patterns, such as large cash deposits inconsistent with customer profiles, frequent structuring to avoid reporting thresholds, or rapid movement of funds through multiple accounts. Suspicious transaction reporting to the

FMU is compulsory when institutions have reasonable grounds to suspect that funds are linked to predicate offenses or terrorist financing, with strict confidentiality requirements and safe harbor protections for good-faith reporting. Internal compliance functions must include dedicated AML/CFT units, independent audits, staff training programs, and escalation mechanisms for unusual activity (Khan et al., 2025).

The SBP has emphasized technology-driven solutions, encouraging the use of automated transaction monitoring systems, name-screening software, and data analytics to enhance detection capabilities. Financial institutions are also required to maintain records for at least five years, cooperate with FMU requests for additional information, and implement controls over correspondent banking relationships. In the context of digital financial services, including mobile wallets and branchless banking, institutions face additional responsibilities to verify identities in non-face-to-face environments and monitor high-velocity, low-value transactions that may be exploited for layering illicit funds (Sadozai et al., 2025).

Research Gap

While existing literature extensively covers the evolution of Pakistan's AML/CFT legal framework, FATF compliance efforts, and high-level policy reforms, there is limited in-depth analysis of the practical implementation challenges and operational realities faced by financial institutions. Few studies explore how banks and other reporting entities translate regulatory obligations into daily practices, the effectiveness of risk-based approaches in resource-constrained settings, or the impact of technological adoption on preventive outcomes. This gap in institution-level empirical and qualitative research hinders a comprehensive understanding of the preventive role of financial gatekeepers in Pakistan's regime.

RESEARCH METHODOLOGY

Research Design

This study employs a qualitative doctrinal and descriptive research design, which is well-suited to examining the legal, regulatory, and operational dimensions of Pakistan's AML/CFT regime with a specific focus on the preventive role of financial institutions. The research is primarily library-based and normative, centering on the analysis and interpretation of legal texts, regulatory guidelines, official reports, and institutional practices. A descriptive-comparative element is incorporated to highlight how obligations imposed by the Anti-Money Laundering Act, 2010, State Bank of Pakistan regulations, and FATF standards translate into practical measures within financial institutions. The design avoids large-scale empirical surveys or quantitative modeling, instead prioritizing in-depth understanding of compliance frameworks, implementation challenges, and effectiveness of preventive controls. This approach enables a structured evaluation of both the "law on the books" and the "law in action" as experienced by regulated entities in Pakistan.

Data Collection Method

Data were gathered exclusively through secondary sources using systematic document review and legal research techniques. Primary legal materials including the Anti-Money Laundering Act, 2010 (as amended), SBP AML/CFT Regulations, FMU guidelines, FATF mutual evaluation reports on Pakistan, and relevant circulars were collected from official websites of the State Bank of Pakistan, Financial Monitoring Unit, Ministry of Finance, and FATF. Secondary sources comprised policy documents, annual reports of the SBP and FMU, FATF follow-up reports, APG mutual evaluation documents, and academic and practitioner analyses available through online legal databases and institutional repositories. Only English-language materials or officially translated versions were utilized to ensure consistency (Asghar, Bhatti, & Ch, 2022).

Sample Size

The study focuses on a purposive selection of key components of Pakistan's AML/CFT ecosystem rather than a statistical sample. It examines the regulatory framework applicable to commercial banks, Islamic banks, microfinance banks, and development finance institutions regulated by the SBP (approximately 50 institutions as of the study period). In addition, the research analyzes guidance and reports issued by the SBP and FMU, as well as Pakistan's FATF mutual evaluation report (2021) and subsequent follow-up reports. This targeted scope provides sufficient depth to assess the preventive role of financial institutions without requiring exhaustive coverage of every regulated entity (M. U. Zafar, Baig, et al., 2024).

Sampling Technique

Purposive (judgmental) sampling was employed to select the most relevant and information-rich sources. Priority was given to documents that directly address the obligations, guidance, supervision, and compliance performance of financial institutions in Pakistan. Key criteria for inclusion were: relevance to AML/CFT preventive measures, recency (post-2018 reforms receiving particular emphasis), authoritativeness (official regulatory or international evaluation sources), and representativeness of major banking sector segments. This non-probability technique ensures that the analysis concentrates on high-value materials capable of illuminating the research questions effectively (S. Zafar, Zaib, et al., 2024).

Data Collection

Data collection proceeded in a phased and systematic manner. First, core legal texts and regulations were retrieved from official SBP and FMU portals and archived for reference. Second, FATF and APG evaluation reports, along with Pakistan's national risk assessment documents, were accessed to provide contextual benchmarks. Third, supplementary materials such as SBP circulars on risk-based approaches, suspicious transaction reporting formats, and compliance program expectations were gathered chronologically to trace regulatory evolution. Each document was reviewed, annotated, and organized thematically under categories such as customer due diligence, transaction monitoring, reporting obligations, internal controls, and supervisory enforcement (Shami, Khaled, et al., 2025).

Data Analysis

The collected data underwent thematic content analysis and doctrinal interpretation. Legal provisions, regulatory instructions, and evaluation findings were categorized according to core preventive responsibilities: risk assessment, CDD/EDD, ongoing monitoring, suspicious transaction reporting, internal governance, and supervisory oversight. Comparative analysis was applied to contrast Pakistan's framework with FATF expectations, identifying areas of alignment, partial compliance, and implementation gaps. Qualitative evaluation assessed the practical feasibility of requirements for financial institutions, considering resource constraints, technological adoption, and enforcement realities. The analysis remained interpretive, focusing on synthesizing insights into the effectiveness of financial institutions as preventive gatekeepers within Pakistan's AML/CFT regime (Asghar, Shami, & Ashraf, 2025).

RESULTS AND DISCUSSION

AML/CFT Compliance Practices

Financial institutions in Pakistan have made measurable progress in embedding AML/CFT preventive measures into their operational frameworks, largely driven by stringent State Bank of Pakistan (SBP) regulations and the need to maintain FATF compliance. Most commercial and Islamic banks have implemented formalized risk-based approaches, conducting institutional risk assessments that identify vulnerabilities related to customer types, products (such as trade finance, remittances, and digital

payments), geographic exposure, and delivery channels. Customer due diligence (CDD) procedures are now standard at onboarding, with identity verification typically supported by NADRA biometric checks, CNIC scanning, and, in many cases, integration with the SBP's e-KYC system. Enhanced due diligence is applied consistently to high-risk categories, including politically exposed persons (PEPs), non-resident Pakistanis, customers from high-risk jurisdictions, and those involved in cash-intensive businesses.

Transaction monitoring systems have become more prevalent, particularly among larger banks, where automated rules-based and, increasingly, AI-supported analytics flag unusual patterns such as structuring, rapid layering of funds, or transactions inconsistent with known customer profiles. Suspicious transaction reporting (STR) volumes to the Financial Monitoring Unit (FMU) have risen steadily since 2018, reflecting improved internal detection and a cultural shift toward proactive reporting rather than defensive compliance. Internal compliance functions are generally well-established, with dedicated AML units, annual staff training programs, and independent audits mandated by SBP guidelines. Digital financial service providers, including mobile wallet operators, have adapted CDD processes for non-face-to-face onboarding through tiered risk-based limits, biometric authentication, and real-time monitoring of high-velocity micro-transactions. Overall, compliance practices demonstrate a maturing regime, with larger institutions showing higher sophistication in technology adoption and risk management, while smaller and rural-focused entities rely more on manual processes and basic rule sets.

Challenges Faced by FIs

Despite legislative and regulatory advancements, financial institutions in Pakistan continue to confront significant operational, resource, and systemic challenges that limit the full effectiveness of their preventive role. One of the most persistent issues is the high volume of cash-based transactions and the large informal economy, which complicates customer profiling and makes it difficult to establish expected transaction patterns for many legitimate clients, particularly in agriculture, small retail, and remittances-dependent households. This environment increases false-positive alerts in transaction monitoring systems, straining compliance teams and diverting attention from genuine risks.

Resource constraints are acute for smaller banks, microfinance institutions, and emerging fintech players, where dedicated AML staff, advanced analytics tools, and ongoing training remain limited due to cost considerations. The rapid growth of digital financial services has introduced new vulnerabilities such as account takeover fraud, mule account recruitment via social engineering, and exploitation of low-value thresholds that existing monitoring systems are not always equipped to detect efficiently. Obtaining timely and accurate beneficial ownership information remains problematic, especially for complex corporate structures or trusts, despite improvements in SECP registries.

Correspondent banking relationships continue to exert pressure; international banks apply enhanced scrutiny and, in some cases, de-risking, increasing compliance costs and limiting access to global payment networks for smaller Pakistani institutions. Staff turnover in compliance roles, limited availability of specialized forensic expertise, and occasional delays in FMU feedback on reported STRs further hamper institutional learning and refinement of detection capabilities. These challenges highlight that while legal obligations are largely in place, translating them into consistently effective prevention across the diverse banking sector remains uneven.

Impact of Regulatory Framework

The regulatory framework overseen by the SBP, in alignment with FATF standards and post-Grey List reforms, has had a demonstrably positive impact on elevating the preventive posture of financial institutions in Pakistan. The risk-based supervisory approach adopted by the SBP prioritizing on-site inspections, off-site monitoring, and thematic reviews has compelled institutions to strengthen

governance, invest in compliance infrastructure, and integrate AML/CFT considerations into business decisions. The imposition of administrative penalties for non-compliance, coupled with public disclosure of enforcement actions, has created strong deterrence and incentivized proactive behavior.

Pakistan's exit from the FATF Grey List in 2022 served as a powerful catalyst, accelerating adoption of automated screening tools, improved STR quality, and better utilization of FMU intelligence in institutional risk assessments. The regulatory push toward digital KYC and centralized databases has reduced onboarding friction for low-risk customers while enhancing traceability for higher-risk ones. Overall, the framework has contributed to increased financial transparency, a measurable rise in money laundering and terrorist financing convictions linked to financial intelligence, and greater resilience against illicit flows.

However, the impact is tempered by implementation gaps. While larger banks demonstrate robust compliance, smaller institutions often adopt a checklist approach rather than genuine risk understanding, reducing the framework's preventive depth. The absence of mandatory technology investment thresholds or shared compliance platforms limits scalability for resource-constrained entities. Nonetheless, the regulatory architecture has undeniably shifted financial institutions from passive reporters to active participants in disrupting illicit finance, laying a foundation for sustained improvement as digitalization and financial inclusion expand in Pakistan.

CONCLUSION

Summary of Findings

This study has demonstrated that financial institutions in Pakistan play an indispensable role as the primary gatekeepers in the national AML/CFT regime, serving as the first line of defense against the infiltration of illicit funds into the formal financial system. The legal and regulatory framework, centered on the Anti-Money Laundering Act, 2010 (as amended), State Bank of Pakistan regulations, and alignment with FATF standards, has evolved considerably, particularly following Pakistan's successful exit from the FATF Grey List in 2022. Financial institutions have implemented risk-based preventive measures, including institutional risk assessments, robust customer due diligence at onboarding, enhanced scrutiny for high-risk customers, automated transaction monitoring, and consistent reporting of suspicious transactions to the Financial Monitoring Unit. Larger commercial and Islamic banks exhibit relatively sophisticated compliance practices, supported by technology-driven screening tools, dedicated AML units, and regular staff training, while smaller institutions and emerging fintech entities show progress but remain constrained by resource limitations.

The regulatory push from the SBP has fostered greater institutional accountability, increased STR volumes, and improved quality of financial intelligence feeding into law enforcement investigations. Nonetheless, persistent challenges undermine full effectiveness: the prevalence of cash-based transactions and a substantial informal economy complicates customer profiling and generates excessive false positives; digital financial services introduce new vulnerabilities such as account misuse and mule networks; beneficial ownership transparency remains inconsistent for complex structures; and correspondent banking pressures continue to impose compliance costs. While the framework has contributed to measurable outcomes enhanced convictions, reduced terrorist financing risks, and sustained international confidence the preventive impact of financial institutions is uneven across the sector. Overall, the findings affirm that Pakistan's AML/CFT regime has strengthened significantly, yet the preventive efficacy of financial institutions depends critically on bridging implementation gaps, scaling technological adoption, and addressing structural economic realities.

Contribution to Literature

This research contributes meaningfully to the existing body of knowledge on AML/CFT in developing economies by shifting the analytical focus from high-level legislative design and FATF compliance evaluations to the operational realities and preventive responsibilities of financial institutions in Pakistan. While prior studies have extensively documented Pakistan's journey through Grey List periods, national risk assessments, and policy reforms, comparatively few have examined in depth how regulated entities particularly banks translate abstract obligations into daily compliance practices, internal controls, and risk management decisions. By highlighting the practical application of risk-based approaches, the challenges of technology adoption in resource-constrained settings, and the interplay between regulatory expectations and institutional capacity, this study fills an important gap in institution-level analysis.

It provides a nuanced understanding of how global standards are localized within a jurisdiction characterized by high remittance flows, rapid digitalization, and a large informal sector, offering insights that are relevant not only to Pakistan but also to other middle-income countries facing similar structural constraints. The research underscores the critical linkage between supervisory effectiveness, institutional commitment, and tangible disruption of illicit financial flows, thereby enriching the literature on the "law in action" dimension of AML/CFT regimes. Furthermore, by identifying specific operational bottlenecks such as false-positive overload, limited forensic capabilities, and correspondent banking frictions it offers actionable entry points for future policy refinement and capacity-building initiatives. In doing so, the study bridges the divide between international normative expectations and domestic implementation realities, contributing a grounded, context-specific perspective to the broader discourse on financial institutions as preventive actors in global anti-money laundering efforts.

LIMITATIONS AND FUTURE RESEARCH

This study is subject to several limitations inherent in its design and scope. As a primarily qualitative, doctrinal, and desk-based analysis relying on secondary sources regulatory texts, official reports, FATF evaluations, and publicly available compliance data it does not incorporate primary empirical evidence from interviews with compliance officers, internal audits, or direct observation of institutional practices. Consequently, the findings reflect reported and documented compliance efforts rather than unfiltered operational realities or the full extent of undetected weaknesses. The focus on SBP-regulated financial institutions excludes a detailed examination of non-bank reporting entities such as designated non-financial businesses and professions, whose preventive role is equally important but operates under different supervisory arrangements. Time and resource constraints also limited the depth of analysis of emerging fintech platforms and digital payment ecosystems, which are rapidly reshaping risk profiles.

Future research should address these gaps through mixed-methods approaches that combine quantitative analysis of STR data, prosecution outcomes, and compliance breach trends with qualitative insights from semi-structured interviews with AML officers, regulators, and FMU analysts. Longitudinal studies tracking the evolution of compliance practices over the next five years would reveal whether recent technological investments and supervisory enhancements yield sustained improvements in preventive effectiveness. Comparative research examining Pakistan alongside other post-Grey List jurisdictions in South Asia or the Middle East could illuminate transferable lessons on balancing financial inclusion with robust AML controls. Investigations into the role of artificial intelligence and machine learning in transaction monitoring, as well as the impact of public-private partnerships on information sharing, would be particularly timely given the accelerating digitalization of Pakistan's financial sector. Finally, victim-centered or predicate-offense-focused studies exploring how financial intelligence generated by institutions contributes to dismantling organized crime and terrorist networks would provide a more outcome-oriented evaluation of the regime's ultimate success. Addressing these directions will be

essential to refining Pakistan's AML/CFT architecture and maximizing the preventive contribution of its financial institutions.

RECOMMENDATIONS

Strengthen CDD and Monitoring

To maximize the preventive role of financial institutions in Pakistan's AML/CFT regime, the first priority should be to further strengthen customer due diligence (CDD) and transaction monitoring practices across all regulated entities. The State Bank of Pakistan should mandate more granular, risk-based CDD requirements that go beyond basic identity verification to include comprehensive beneficial ownership identification, even for low-value accounts, using integrated access to updated SECP registries, NADRA databases, and emerging centralized beneficial ownership platforms. Simplified due diligence should be restricted to truly low-risk scenarios, with clear thresholds and periodic reviews to prevent abuse. For high-risk customers such as politically exposed persons, non-residents, cash-intensive businesses, and those linked to high-risk jurisdictions institutions should be required to apply enhanced due diligence consistently, including source-of-funds and source-of-wealth inquiries, senior management approval for account opening, and more frequent reviews of business relationships.

Transaction monitoring systems must evolve from basic rule-based alerts to advanced, behavior-based analytics incorporating machine learning and artificial intelligence to reduce false positives and improve detection of sophisticated layering and structuring techniques. SBP regulations should set minimum standards for technology adoption, including mandatory integration of name-screening against domestic and international sanctions lists, real-time monitoring of digital payment channels, and automated flagging of high-velocity micro-transactions typical of mobile wallets and branchless banking. Institutions should also be encouraged to adopt consortium-based data-sharing mechanisms (within privacy safeguards) to identify mule account networks and cross-institutional suspicious patterns. Regular stress-testing of monitoring systems against emerging typologies such as trade-based money laundering, cryptocurrency-linked flows, and virtual asset service provider interactions would ensure adaptability. These enhancements would enable financial institutions to shift from reactive compliance to proactive disruption of illicit flows, particularly in Pakistan's rapidly digitizing financial ecosystem.

Capacity Building

Sustainable effectiveness of AML/CFT prevention hinges on continuous capacity building within financial institutions, regulatory bodies, and the broader compliance ecosystem. The SBP, in collaboration with industry associations and training institutes, should develop and mandate structured, tiered training programs for AML/CFT staff at all levels from frontline officers to senior management and board members. Training should cover not only regulatory obligations but also practical skills in recognizing red flags, interpreting complex transaction patterns, conducting effective beneficial ownership inquiries, and preparing high-quality suspicious transaction reports. Annual certification or competency assessments for key compliance personnel could be introduced to ensure ongoing proficiency.

Smaller banks, microfinance institutions, and fintech entities, which often face resource constraints, require targeted support through subsidized training initiatives, shared compliance resource pools, and SBP-facilitated technology adoption grants or low-cost licensing for monitoring software. The Financial Monitoring Unit should expand its outreach by providing regular feedback loops to reporting institutions on the quality and utility of STRs, enabling institutions to refine detection criteria and reduce unnecessary reporting burdens. Peer-learning platforms, where larger institutions share anonymized best practices with smaller peers, could accelerate knowledge transfer. Additionally, SBP should promote recruitment and retention of specialized AML talent by recognizing compliance roles as critical career paths and

encouraging professional certifications such as CAMS or equivalent. These capacity-building measures would address the current uneven implementation across the sector, ensuring that preventive responsibilities are discharged competently regardless of institutional size or geographic location.

Regulatory Collaboration

Effective prevention of money laundering requires seamless collaboration among regulators, financial institutions, and other stakeholders to close gaps and leverage collective strengths. The SBP should deepen coordination with the Financial Monitoring Unit to establish faster, structured feedback mechanisms on STRs and to jointly develop sector-specific risk indicators and typologies tailored to Pakistan's economic context such as remittances, trade finance, and agricultural cash flows. Regular joint workshops and case-sharing sessions would enhance mutual understanding and improve the actionability of financial intelligence.

Inter-agency collaboration must extend beyond SBP and FMU to include the Securities and Exchange Commission of Pakistan, Federal Board of Revenue, provincial counter-terrorism departments, and law enforcement agencies. A formalized inter-agency task force or steering committee could prioritize high-risk predicate offenses, coordinate parallel financial investigations, and ensure that intelligence generated by financial institutions translates into timely prosecutions. Public-private partnerships should be institutionalized, encouraging financial institutions to participate in national risk assessment updates, share anonymized threat intelligence, and collaborate on preventive initiatives such as industry-wide awareness campaigns against mule account recruitment.

Internationally, Pakistan should continue strengthening correspondent banking relationships through demonstrated compliance and proactive engagement with foreign regulators to reduce de-risking pressures. SBP should also facilitate bilateral memoranda of understanding with key remittance corridors to improve traceability of cross-border flows. By fostering a collaborative regulatory environment characterized by information sharing, joint capacity building, and aligned priorities the preventive impact of financial institutions can be significantly amplified, transforming them from isolated reporters into integral components of a cohesive national AML/CFT defense architecture.

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