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Terrorism Financing in Pakistan: Legal, Institutional, and Operational Challenges in a Risk-Based AML/CFT Framework

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ABSTRACT

Financial borders play an instrumental role, analogous to the role of physical borders, to maintain the security of the state in the modern global environment. For instance, Pakistan accomplished an important milestone in October 2022 by being taken off the list of countries under FATF's heightened monitoring program – a significant achievement that marks another important step in Pakistan's struggle with financial crime. However, this accomplishment only reflects the start of a more complicated journey considering that financial crime continues evolving continuously. This research work 'Terrorism Financing in Pakistan: Legal, Institutional, and Operational Challenges in a Risk-Based AML/CFT Framework' scrutinizes the problems associated with the implementation of regulatory measures to address financial crime. Despite having an extensive set of legislative mechanisms, such as the 'Anti-Terrorism Act, 1997,' and 'Anti-Money Laundering Act, 2010', Pakistan faces significant practical challenges to successfully combating terrorism financing. Notably, certain friction points that hamper the tracing and prosecution of illegal networks are identified in the course of research. According to the results of this work, there are three critical risks threatening the financial well-being of the country. Firstly, this is the underground economy, manifested through the use of untraceable sources, including, but not limited to hawala and hundi systems. Secondly, the misuse of humanitarian organizations by malicious individuals constitutes another problem faced by Pakistan. Thirdly, there are financial schemes connected with smuggling operations which contribute to extremist organizations' finances. Moreover, growing risks related to virtual assets are mentioned since they allow carrying out cross-border anonymous payments. Overall, Pakistan should consider moving from merely fulfilling its international obligations to developing a human-oriented and local-based solution. It implies shifting focus from formal compliance with regulations to enhancing legislation for protecting the country's economic welfare.

Keywords: *Terrorism, Legal Institutional, Pakistan*

INTRODUCTION

Financial terrorism continues to be one of the major threats to the security and stability of Pakistan. The country has developed a comprehensive framework of laws against money laundering and terrorist financing (AML/CFT), which are incorporated in its Anti-Terrorism Act (ATA) 1997 (amended); Anti-Money Laundering Act (AMLA) 2010 (amended); United Nations (Security Council) Act 1948, and specific sectoral laws. As per recent FATF evaluations, Pakistan has made notable progress towards improving its AML/CFT framework, and as such, it was taken out of the FATF grey list in October 2022. However, several concerns persist. Some of the key observations are that AMLA and ATA now expressly outlaw TF activities (sections 11 H-K and 11-N). Various institutional structures have been put in place, most significantly the FMU at the SBP and NACTA. While Pakistan has strengthened its legal framework on AML/CFT, enforcement has been ineffective. High-risk channels of hawala/hundi, cash couriers, informal MVTS, and NPOs continue to represent potential vulnerabilities. Capacity and coordination issues were experienced by courts and LEAs. This article examines Pakistan's AML/CFT legal framework and institutional mechanisms, including SBP and SECP guidance documents; risk-based approach implementation, including National Risk Assessments; challenges faced in the banking sector, informal remittance transfers, and charities; data on enforcement efforts (including prosecutions, convictions, asset freezes), and recommendations for improvements, specifically the effective prosecution of TF cases; coordinated supervision of NPOs; improved coordination among agencies; robust financial intelligence gathering, and fine-tuning legislation.

Legal and Regulatory Framework

The laws on AML/CFT in Pakistan are a result of a combination of both anti-terrorism and financial legislation that is in line with international UN and FATF guidelines. With respect to financing of terrorism, the core offenses are established in the Anti-Terrorism Act (ATA) of 1997 through Sections 11H-11K, which include criminalizing terrorist funding activities such as fundraising for terrorists, possession and use of funds by terrorists, arrangement of funds, and money laundering, with penalties applicable under Section 11-N (Adil, 2020). Under the prohibition measures of the ATA, whereby listing of proscribed organizations and individuals is conducted, the preventive measures apply to companies. Some of the significant revisions made in 2020 include criminalizing defiance of the UN Security Council resolutions on freezing assets through adding Section 11-OOO, along with extending prohibition on loans and credits to proscribed persons. (Adil, 2020). An example is where banks cannot issue credit cards to those proscribed under the law. These modifications harmonise domestic legislation with UN Security Council Resolutions, such as UNSCR 1373 of 2001, which mandate asset freezes and the criminalisation of support for terrorism (*Guidelines on Compliance of UNSC Resolutions*, n.d.).

Within the arena of financial crimes prevention, the most significant piece of legislation is Anti-Money Laundering Act, 2010 (amended version). As per the Act, money laundering is made a criminal offense and preventive measures in line with Vienna and Palermo conventions are provided (Adil, 2020). It makes for the creation of the Financial Monitoring Unit (FMU) at the State Bank (section 7A) responsible for collection, analysis, and disseminating suspicious transaction reports (STRs) to law enforcement authorities (Adil, 2020). According to the Act, "any person who converts, transfers, conceals or disguises" proceeds of crime shall be deemed money launderer and punished with imprisonment under the Act (*Anti-Money-Laundering-Act-2010-Amended-Upto-Sep. 2020.Pdf*, n.d.) Further, under the Act, FMU is empowered to attach, seize, and forfeit assets used for laundering purposes. In 2020, some new committees of general nature were established with regard to implementation of AML/CFT policy. An Executive Committee headed by Finance Minister and General Committee headed by Finance Secretary was set up in 2020 (Adil, 2020). There is also a non-obstante clause in the Act which means that AMLA overrides any conflicting law (*Commentary on the Anti-Money Laundering Act 2010*, n.d.) underscoring its primacy.

The UNSC sanctions are implemented through the United Nations (Security Council) Act, 1948. According to this legislation, Chapter VII decisions can be implemented through Statutory Regulatory Orders (SROs) issued by the Federal Government. As stated in Guidelines on Compliance of UNSC Resolutions, SROs that restrict asset ownership, prohibit travel, and arms embargo for listed individuals and entities are promulgated by the Ministry of Foreign Affairs (MoFA). UNSCR 1373 domestic sanctions are imposed using the proscription notification provided by the Ministry of Interior under the Anti-Terrorism Act (ATA).

The State Bank disseminates SROs on designated entities and individuals to banks and other financial institutions and instructs them to "freeze without delay their accounts and resources." (*Guidelines on Compliance of UNSC Resolutions*, n.d.).

Other laws have further strengthened the country's AML/CFT regulations. For instance, the NACTA Act 2013 established the National Counter Terrorism Authority, an apex body responsible for the formulation and coordination of policies on terrorism and extremism. Choking financing for terrorists is mentioned as one of the key pillars in Pakistan's National Action Plan (NAP) 2014, which is a policy framework. Among others, it requires the regulation of cash transactions, the freezing of funds, non-governmental organization (NGO) oversight, and control over the use of hawala money transfer services (*National Action Plan, 2014 – NACTA – National Counter Terrorism Authority NACTA Pakistan*, n.d.) Similar measures have been incorporated in later versions of the policy framework. Corporate sector-wise reforms include amendments in the Companies Act 2017 requiring the determination of ultimate beneficiaries and regulation of charitable trusts, for example, the ICT Waqf Act 2020. Provincial charity laws passed in 2018 (Punjab) and 2019 (Sindh, Khyber Pakhtunkhwa, Balochistan) regulate NGOs and charities, allowing audits on funding and freezing of bank accounts where required.

Major rulings have been quite influential for the field. In 2009, the Supreme Court struck down Article 270AAA of the Constitution, which provided for retrospective validation of previous AML ordinances, reaffirming that AML ordinances should have legislative approval (*Commentary on the Anti-Money Laundering Act 2010*, n.d.) As a result, AMLA 2010 became enacted into legislation to replace those ordinances that were set to expire. More recent, in 2018, Lahore High Court declared SRO 611(I)/2016 extending investigative powers of AMLA to the Intelligence and Investigation wing of the FBR ultra vires and therefore nullifying all powers that the FBR had gained through the ruling (*FBR Resents Challenge to Anti-Money Laundering Powers - Pakistan - DAWN.COM*, n.d.) Thus, the ruling has led to putting the investigation on hold, proving how any violation of the procedure, like promulgating SROs without Cabinet approval, can hamper the enforcement process. In the domain of TF, one can consider the case of Lashkar-e-Taiba (LeT) leader Hafiz Saeed, who received a 31-year jail sentence for two counts of terrorism in 2022 (Bukhari, 2022). Though not a precedent for higher courts, it showed the successful use of ATA provisions.

Institutional Architecture

Pakistan's AML/CFT framework encompasses many entities across the financial and security sectors. Principal institutions comprise:

1. Financial Monitoring Unit (FMU**)** – the Financial Intelligence Unit of Pakistan situated in the State Bank of Pakistan. FMU receives suspicious transaction reports (STRs) and cash transaction reports from banks and DNFBPs; analyzes them and distributes intelligence to enforcement agencies (Adil, 2020). The FMU maintains national registers of high-risk individuals and ensures that Pakistan maintains its commitment to the Egmont Group (FIU network). FMU also acts as the chairperson of the National FATF Secretariat, responsible for AML/CFT coordination between various ministries (*Terror-Financing-1.Pdf*, n.d.). It regularly publishes Money Laundering/Terror Financing Risk Assessment and typologies.

2. State Bank of Pakistan (SBP) – SBP acts as AML/CFT regulator for banks, exchange companies, microfinance banks, and associated institutions. The State Bank of Pakistan issues prudential guidelines (such as rules for customer due diligence and Terrorist Financing Screening guidelines) and directives (like the freezing of the account of sanctioned persons "without delay" (*Guidelines on Compliance of UNSC Resolutions*, n.d.) SBP is also responsible for ensuring the AML/CFT requirement compliance by financial institutions through inspections and other means.

3. Securities and Exchange Commission of Pakistan (SECP) – SECP is the regulator of capital markets, insurers, non-bank financial companies (NBFCs), brokerages, and the corporate sector. SECP has promulgated anti-money laundering rules for these sectors and carries out risk-based supervision. SECP also regulates the Non-Profit Associations under the Voluntary Social Welfare Agencies (Registration and Control) Ordinance.

4. Enforcement Agencies – Various enforcement agencies carry out investigations according to the AMLA/ATA. The Federal Investigation Agency (FIA), under the Ministry of Interior, has an Anti-Money Laundering Wing and a separate Counter-Terrorism Department (CTD) for TF cases. ANF works against drug trafficking and other related money laundering activities. National Accountability Bureau (NAB) is tasked with handling corruption cases and has limited AML/TF jurisdiction. The FBR Intelligence & Investigation (I&I) Wing was authorized (and subsequently stripped of) investigating money laundering for tax evasion cases (*FBR Resents Challenge to Anti-Money Laundering Powers - Pakistan - DAWN.COM*, n.d.) The special anti-terrorism courts have been established to hear terror and TF cases under the ATA.

5. Coordinating Bodies – The National Counter-Terrorism Authority (NACTA) leads national CFT policy. NACTA heads the National Task Force on Countering Financing of Terrorism (multi-agency platform) to coordinate strategy and monitoring. It also manages the implementation of the National Action Plan through provincial apex committees (*National Action Plan, 2014 – NACTA – National Counter Terrorism Authority NACTA Pakistan*, n.d.).

Risk-Based Approach and National Risk Assessment

In accordance with FATF, Pakistan embraces the risk-based approach (RBA). Successive National Risk Assessments (NRAs) have been carried out concerning ML/TF in 2017, 2019, and 2023 (*SUMMARIZED NATIONAL RISK ASSESSMENT 2023*, n.d.) The latest NRA (2023) identifies ML/TF risks and vulnerabilities faced by Pakistan. The main threats and vulnerable sectors for ML include "illegal MVTS/Hawala/Hundi," cash smuggling, and misuse of trade. TF risks include donations and extortion as Very High-risk sources and "illegal MVTS" and cash couriers as very-high-risk transport mechanisms. As to the sectors vulnerable to ML and TF, traditional banking organizations are deemed to pose "very high" risk to ML while NBFCs and insurance institutions fall into the medium-to-low categories due to poor supervision by SBP and SECP.

Pakistan’s regulatory authorities transform NRA results into regulatory provisions. The State Bank of Pakistan and Securities and Exchange Commission of Pakistan implement risk-based AML/CFT policies, including EDD for clients presenting higher risk. The Banking Act and Anti-Money Laundering Act (AMLA) stipulate CDD measures as well as require banks to keep records (Adil, 2020). Cryptocurrency exchanges and VASPs are insufficiently regulated, thus posing new TF risks. The FMU and NECC update the sectoral risk assessment and notify banks and other reporting organizations of such changes in order to adjust monitoring thresholds accordingly.

Operational Challenges

Financial Sector Compliance

The formal financial sector of Pakistan demonstrates various compliance features related to AML/CFT. On the one hand, major banks utilize software for transaction screening and reporting suspicious activities. SBP guidelines instruct institutions to perform customer screening according to the United Nations and proscription lists, freeze suspect accounts and report to the FMU. (*Guidelines on Compliance of UNSC*

Resolutions, n.d.) On the other hand, weaknesses appear when enforcing regulatory measures, e.g., the APG discovered that DFIs, MFI, and non-banking sector organizations conduct little to no filtering for TF (scarce filter lists and alerts) (Pakistan MER 2019, n.d.). Small organizations (e.g., NBFCCs and microfinance banks) are viewed as high-risk institutions due to poor monitoring. (*SUMMARIZED NATIONAL RISK ASSESSMENT 2023*, n.d.)

According to the NRA, profits from predicate offenses often laundered through real estate market, precious metal dealers, and shell companies (*SUMMARIZED NATIONAL RISK ASSESSMENT 2023*, n.d.). The assessment of DNFBPs (Dealers in Precious Metals/Stones, real estate agents, attorneys/accountants) revealed that DMPS dealers were classified as having a "high" money laundering risk, but lawyers and accountants were categorised as medium to low risk, indicating inconsistent oversight. The enforcement ability is constrained: Pakistan has a minimal number of money laundering convictions despite many investigations (Pakistan MER 2019, n.d.). The "law enforcement gap" indicates a need to enhance evidence collecting and prosecution skills, as highlighted by the APG (*Pakistan MER 2019*, n.d.)

Hawala/Hundi and Informal Remittances

Unofficial value-transfer mechanisms are an inherent weakness in the AML/CFT architecture. Hawala or hundi systems are deeply embedded in Pakistan's economic fabric, especially in rural settings, and are significant players in the transfer of funds from foreign sources. As such, the networks are by nature beyond the formal banking system and thus have no accountability for any transactions. Pakistan's AMLA bans unauthorized MVTS or unregistered money or value transfer service providers, but there is no effective enforcement. The NRA report clearly states that illegal MVTS, hawala, or hundi poses a very high ML risk and is one of the main TF vehicles (*SUMMARIZED NATIONAL RISK ASSESSMENT 2023*, n.d.). Likewise, "cash couriers" (physical cash transportation) are highlighted as being very high TF risks. Previous FATF assessments have identified inadequate regulation of hawala in Pakistan. Some achievements have been made (for example, licensing for remittance firms and reporting on transactions); however, informal transfers still happen, especially through the poorly controlled Afghan-Pakistan border and tribal territories. Regulatory actions have been taken in supervision and monitoring, such as banking correspondents and monitoring of exchange firms. Enforcement data are not available.

Charities and NGOs

There have been historical instances where Non-Governmental Organizations (NGOs) in Pakistan have faced instrumentalization for financing extremist activities. As a result, the government has taken stringent measures by mandating that all NGOs be registered with a provincial authority, share bank account details with the Securities and Exchange Commission of Pakistan (SECP), and, in several cases, having security agencies represent them in the governing board of the organizations. Under provincial charitable legislation such as the Sindh Charities Act 2019, authorities are permitted to freeze and shut down NGOs whenever there are grounds to believe that they might be linked to terror acts (National Action Plan, 2014; NACTA—National Counter Terrorism Authority Pakistan, n.d.). Furthermore, the country has a "safe list" of vetted NGOs meant for foreign donor agencies. The Financial Monitoring Unit (FMU) has guidelines mandating that beneficiary screenings of NPOs be carried out. Nevertheless, according to the results of the National Risk Assessment, only about 6.8% of Pakistani NPOs fell under the category of high risk, implying that most NGOs are small-sized and cooperative but a few large NGOs with ties to banned organizations or extremism continue to cause problems (SUMMARIZED NATIONAL RISK ASSESSMENT 2023, n.d.). FATF has continually raised concerns about the regulation of NPOs in Pakistan, while NACTA and SECP have engaged in selective assessments of large NGOs with the issuance of licenses withdrawn following convictions against Hafiz Saeed (*Pakistan: Hafiz Saeed Gets 31 Years in Jail for Terror Financing | News | Al Jazeera*, n.d.)

Enforcement, Prosecution, and Conviction Trends

The enforcement of AML/CFT governance in Pakistan is broadening; however, there is an insufficiency of convictions. There are many agencies investigating cases under AMLA and ATA; nevertheless, in the process of moving towards conviction, there is significant attrition. From 2013 to 2018, in Pakistan, 2,420 money-laundering investigations were held; however, there was only one conviction (Pakistan MER 2019, n.d.). This discrepancy is shown in Table 3.11 of APG Report (see Figure 1 below). In particular, ANF opened 1,528 money-laundering cases (for drug-related crimes); the agency initiated 161 prosecutions with 0 convictions; FIA investigated 346 money-laundering cases and got 0 convictions; NAB initiated 32 money-laundering cases, which resulted in 1 conviction (Pakistan MER 2019, n.d.). According to FATF/APG observations, one conviction is not "consistent with Pakistan's risk profile."

CHAPTER 3. LEGAL SYSTEM AND OPERATIONAL ISSUES

3

2016	1138	412	530
2017	1015	948	1142
2018 (to 31-8-2018)	701	671	790
Total	**4951**	**2785**	**3396**
Tax Offences (FBR-IR)			
Year	**Investigations**	**Prosecutions**	**Convictions**
2013-14	485	17	2
2014-15	608	30	-
2015-16	501	35	3
2016-17	604	12	-
Total	**1658**	**94**	**5**
Corruption and Corrupt Practices (NAB)			
Year	**Investigations**	**Prosecutions**	**Convictions**
2013	408	119	71
2014	1113	208	72
2015	1297	238	132
2016	1303	320	56
2017	671	199	105
Total	**4792**	**1084**	**436**

171. Overall, the ML investigation figure is at 2420 with 354 (or 14%) at the prosecution stage. The number of ML convictions since 2013 is only one (1). Despite relatively high numbers of ML investigations for some type of offences - particularly drug trafficking and tax cases - the low percentage of prosecution for some types of major predicate crimes, and overall just one conviction for ML, suggests that the collection of evidence at the investigation stage is not sufficient enough to achieve a reasonable prosecution and conviction rate.

172. ANF initiates the majority of ML investigations related to drug offences. ML investigations by the FIA are next. However, predicate offences under the responsibility of the FIA range from TF, terrorism, human trafficking, small-scale corruption, embezzlement, cheating and others. It is unclear which predicate offences are underlying the above-noted FIA ML investigations. Therefore, it was not possible for the assessment team to determine whether those predicate crimes were major or high risk predicate offences matching Pakistan's risk profile.

173. On the other hand, especially with regard to corruption, some complex ML cases were identified resulting in convictions of high-ranking public officials in the Pakistan government. In those investigations, collaboration among different law enforcement agencies took place through joint investigation teams (or, JITs). Successful results were achieved. Reports of some of these investigations are publicly available (e.g. http://www.supremecourt.gov.pk/web/page.asp?id=2506).

174. The following factors contribute to the circumstances in which potential ML cases are identified and investigated:

- Pakistan informed the assessment team that LEAs take into account the financial aspects of the offence in each individual case and if there is a suspicion of ML, LEAs investigate ML along with predicate offences. To some extent, some LEAs undertake financial investigations in cases where criminal proceeds are believed to be obtained. This manifests itself in the number of ML investigations initiated by ANF in relation to drug trafficking. However, LEAs do not systematically conduct parallel financial investigations since the figure for investigations of ML stemming from major predicates (such as people smuggling, extortion, illegal MVTS) is not high.

62 Anti-money laundering and countering the financing of terrorism measures in Pakistan - APG 2019

Figure 1: AML/CFT cases in Pakistan (2013–18) – Investigations vs Prosecutions vs Convictions (Source: *Pakistan MER 2019*, n.d.)

As far as TF is concerned, till mid-2018, there were just 58 TF cases convicted in the country. Particularly, 49 convictions for TF took place in Punjab, and the rest of the cases were distributed among other provinces, which means that there is no consistency in TF enforcement within the territory of Pakistan. Senior analysts estimate a TF conviction rate of 5-10% [38]. It is necessary to clarify that in this context we talk only about civilian courts; terrorism prosecutions by military courts (under Army Act provisions) are not included. The case of the high-profile arrest of Hafiz Saeed in 2022 (the court sentenced him to 31 years for TF) was partly regarded as a signal to FATF. Moreover, the assets of related charities were frozen/ confiscated. The additional example of TF enforcement includes the freezing of Pervez Musharraf's accounts in a treason case (Gul, 2016).

Asset Freezing and Sanctions

Pakistan has both international UN-mandated and national asset-freezing measures in place. As per UNSCR 1267 (sanctions against Al-Qaeda/Taliban) and 1373 (organizations identified as terrorist), SROs issued by the Ministry of Foreign Affairs list individuals and organizations whose assets need to be frozen (Guidelines on Compliance of UNSC Resolutions, n.d.). The anti-terrorism act (ATA) also has national proscriptions. In accordance with the State Bank of Pakistan (SBP), all banks and DFIs are required to instantly freeze "all financial assets or economic resources" of proscribed or sanctioned people or those who may be controlling them. Banks are required to report such freezes to the FMU. According to the SBP guidelines on compliance with UN Security Council resolutions, banks must not provide any banking services to anyone proscribed by the UN or ATA and should conduct due diligence, which includes identifying the beneficial owner and verifying the sanctions list (*Guidelines on Compliance of UNSC Resolutions*, n.d.)

RECOMMENDATIONS AND CONCLUSION

Pakistan has put in place an extensive AML/CFT legal architecture, as well as made significant progress towards compliance with international standards. Indeed, the de-listing of the country from FATF grey list in 2022 proves the commitment of the Pakistani government in dealing with the issue of terrorist financing. However, in the following spheres, there is a need for improvement:

Firstly, Pakistan needs to optimize the ML/TF investigation process with the help of special task forces or specialized units. In particular, restoring the terrorism financing committee of NACTA and making periodic case reviews between agencies will increase efficiency in the fight against TF. There should also be the recruitment of additional financial investigators to FIA and police counter-terrorism department (CTD), whereas special judicial committees or courts should be created in the area of financial crimes; alternatively, judges should be trained for handling financial forensic evidence. One could also explore the possibility of creating plea-bargain mechanisms in TF cases in order to speed up the process when there is no sufficient proof available.

Secondly, regulators have to implement risk-based supervision policies more actively. For example, SBP and SECP can make surprise inspections of DNFBPs and small banks regarding KYC and STR regulations. Reporting entities might be required to conduct regular risk assessments in the form of annual ML/TF risk statements. Moreover, the gap in regulating hawala system must be addressed through registration of all operators and reduction of maximum limit of money that people can handle; the rules concerning the import/export of currencies must be tightened. With respect to non-profit organizations, one should note that NACTA/SECP could inspect the large NGO accounts, and violators be fined; at the same time, recent changes in Pakistani law allow the seizure of extremist religious organizations' assets.

Thirdly, Pakistani government may consider enacting laws that will help to pursue TF and confiscate related assets. Possible amendments include designation of TF as a predicate for AMLA in such a way that funds used for terrorist activities will be classified as predicate proceeds; penalties must be increased for unauthorized use of hawala/hundi channels. Furthermore, it is necessary that TF cases could be investigated via the AMLA non-conviction-based mechanism of asset confiscation. One can amend the criminal procedure law so that TF cases would be tried faster (by establishing, for instance, fast-track courts for ML/TF).In summary, Pakistan's AML/CFT framework has significantly improved, however substantial deficiencies persist in enforcement and risk oversight.

Confronting these challenges—via enhanced inter-agency collaboration, focused law enforcement, and a persistent emphasis on high-risk sectors (hawala networks, unregulated NPOs)—is crucial to impede terrorist funding. The subsequent chronology and comparison table delineate significant legal developments and their repercussions, showcasing both advancements made and regions requiring care. Ongoing surveillance, legal refinement, and capacity enhancement will be essential for Pakistan to effectively mitigate TF dangers and sustain global trust in its AML/CFT initiatives.

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