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INTEGRATED GOVERNANCE CONTEXT IN ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING: A CASE STUDY OF PAKISTAN'S 2018–2022 FATF GREY-LISTING

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Abstract

This article argues that the Financial Action Task Force (FATF) led anti-money laundering(AML) and counter-terrorist financing(CFT) regime operates as a hybrid transnational regulatory architecture: a soft-law standard-setting body whose norms are converted into hard constraints through market access, correspondent-banking risk management, multilateral conditionality, and dense networks of domestic regulators and private compliance actors. The hybrid form has produced remarkable integrated governance framework is essential for effective AML and CFT policies for global convergence on formal legal rules, yet persistent contestation over legitimacy, proportionality, and sovereignty. Using Pakistan's 2018–2022 grey-listing episode as a primary case study, and brief comparative vignettes from other jurisdictions, the article develops an interpretive account of compliance as 'situated agency': domestic actors translate global standards through local institutional logics rather than merely copying them. The article then identifies three recurring tensions (1) performance measurement versus meaningful outcomes, (2) coercive market discipline versus procedural legitimacy, and (3) risk-based regulation versus financial inclusion and rights before proposing reforms that would strengthen accountability and evidence-based assessment without weakening the core objective of protecting the integrity of the international financial system.

Keywords: FATF; Anti-Money Laundering; Counter-Terrorist Financing; Hybrid Governance; Legal Transplants; Financial Inclusion.

1. Introduction

Money laundering (ML) and terrorist financing (TF) are widely referred to as prime transnational issues, as criminals take advantage of cross-border payment supports, legal arbitrage, and haphazard enforcement. The United Nations Office on Drugs and Crime (UNODC) estimates that $800 billion to $2 trillion that is roughly 2–5% of global GDP is laundered annually (UNODC, 2021). Globalization and emerging technologies have further complicated the regulatory landscape by enabling anonymous fund transfers and facilitating sophisticated fraud

schemes that circumvent standard know-your-customer (KYC) protocols (Malik et al., 2022). Despite advanced global anti-money laundering (AML) and counter-terrorist financing (CFT) frameworks their effectiveness remains limited. Recent data highlighting the difficulty of quantifying illicit financial flows of ML due to their clandestine and undercover nature, with the actual figures likely to be substantially higher (Global Financial Integrity, 2017).

In this context, the FATF was established at the G7 Summit in Paris in 1989 and it has emerged as the central standard-setting body for AML and CFT regulation worldwide (van Duyne et al., 2018), coordinating a global network of over 200 member governments through FATF membership and with nine FATF-style regional bodies (FSRBs) (Murrar & Barakat, 2021). Despite its global reach and standardising authority, FATF's official legal status is non-coercive. Its Recommendations do not have a force of law, and it does not directly have a coercive jurisdiction over states or even individual firms (Halliday, 2014; Sharman, 2011).

This paper argues that the integrated architecture of the regime is the most important principle to grasp the role of FATF. The market discipline, especially the compliance choice of the correspondent banks and other globally operating financial intermediaries, in conjunction with the multilateral conditionality, reputational sanctions through the grey and blacklisting, and the domestic administrative translation of soft-law standards into binding rules, transform the soft-law standards into hard-constrained ones. The very hybridization which facilitates quick diffusion also creates long-term tensions: the regime is more likely to reward formal legal convergence where the outcome remains challenging to quantify; it is based on impervious processes which may raise legitimacy concerns; and it can be incompatible with the risk-based approach in a variety of ways which contribute to the de-risking and financial exclusion (FATF, 2021).

Formally the regime is successful as seen in better technical compliance. The synthesis of the mutual evaluation data prepared by the FATF itself reports significant improvements in the way the implementation of the 40 Recommendations is practiced since the beginning of the 2010s. Simultaneously, the identical report also highlights ongoing flaws in the effectiveness, in particular, in the cases where illicit finance is institutionalized in political economy, and in the cases in which asset recovery and positive ownership transparency are hard to achieve (FATF, 2021).

The stakes of integrated governance are best evident in the listing practices of FATF. An emerging empirical literature has indicated that grey listing is linked to significant losses in inflows of capital, which may occur due to the risk management process of banks and the way in which investors perceive an increase in compliance and reputational risk. In the case of countries that are capacity-constrained, listing costs may constitute urgent incentives to show compliance-sometimes faster than institutions can reform sustainably (Tunde et al., 2019; Zavoli et al., 2021).

The case of Pakistan demonstrates the disciplinary ability of the regime as well as its interpretive malleability. After the APG conducted mutual evaluation with the APG in 2019 and FATF

followed, Pakistan took a comprehensive step to reform its legislation and administration, and was removed in October 2022 off the list of jurisdictions being subjected to heightened monitoring by FATF. This case is not discussed as a mere success story but as a chance to consider the issue of how global AML and CFT standards are translated, challenged, and institutionalized during the time pressure (Asia Pacific Group [APG], 2019; FATF, 2022).

The article makes three contributions. First, it provides an integrated account of AML and CFT governance, which is theoretically integrated to connect the transnational legal order scholarship to both interpretive and socio-legal implementation tactics. Second, it analytically realises the concept of situated agency in describing the difference in the result of compliance with similar formal rules. Third, it suggests an institutional reform agenda based on procedural legitimacy, evidence-based analysis, and unintended consequences mitigation- without owing out the core role of the regime promoting the integrity of the global financial system (Halliday & Shaffer, 2015).

2. The FATF-Led Regime as Hybrid Transnational Architecture

The FATF majorly has regulatory tools, such as its 40 Recommendations, with Interpretive Notes, and a methodology through which they peer assess both technical compliance and effectiveness. These are officially non-binding texts that give a common grammar to domestic AML/CFT laws, supervision and enforcement (FATF, 2012-2023).

FATF governance is operationally implemented in a cyclical process of mutual reviews, subsequent reporting and in more risky instances, the International Cooperation Review Group (ICRG) process. The reports of mutual evaluation are either prepared by FATF assessors or by FSRBs like the APG; in both cases, the evaluation is based on a standardized approach but allows scoping to the context. This dual approach of the methodology in both the rules and effectiveness is indicative of an institutional approach of overcoming formalism, but also raises issues in measurement (FATF, 2013; FATF, 2023).

The hybrid nature of the regime is the way soft standards are hardened via a number of channels. First, the market participants, particularly the correspondent banks, payment processors, and other global financial institutions internalize FATF ratings to risk rating, customer due diligence (CDD), and de-risking decisions. Second, financial integrity expectations and conditionality can be integrated into financial integrity assessment and conditionality by multilateral institutions and development finance as well. Third, the domestic regulator converts the FATF expectations into enforceable regulations on banks and other specified non-financial businesses and professions (DNFBPs) frequently within strict political deadlines (Zavoli et al., 2021).

Accountability gaps are also created through hybridization. The FATF is powerful and not readily accommodated in the normative structures of administrative rationality, judicial deference, or democratic control. Practically, the most consequential pressures can be seen to emanate downstream, via private risk governance, and the business choices of financial institutions and not via direct sanctions (Halliday and Shaffer, 2015).

3. Conceptual Framework: Transnational Legal Orders, Interpretation, and Situated Agency

The article is based on the transnational legal orders (TLO) literature, which highlights the institutionalization of transnational norms as the result of recursive relations between global, national, and local actors. According to this perspective, AML and CFT is not a list of international standards that are displayed but a developing legal order that is created and stabilized at assessment cycles, communities of professionals, and domestic translations of world scripts (Halliday and Shaffer, 2015; Halliday and Carruthers, 2009).

The article takes an interpretive view of compliance as a situated agency in order to explain why formal convergence does not always provide similar results. Interpretive methods believe implementation is a meaning-making process: actors do not merely apply rules, they interpret, translate, and occasionally strategically reframe them to institutionalism. This assists in clarifying why nations may appear to be compliant on paper and still fail to be effective and why reforms can be robust in certain situations and fragile in others (Yanow, 1993; Yanow and Schwartz-Shea, 2014).

More specifically, legal interpretivism emphasizes that a legal standard does not preserve its contents through a textual formulation; its contents are partly made by interpretive practices and the justificatory norms pursued by those in charge of the administration as grounds of action. The classic explanation of the rule of recognition provided by Hart also gives relevance to the internal point of view of the officials: by considering FATF standards as authoritative source of domestic compliance expectations, these standards may be used as de facto secondary rule in national legal systems without including them formally (Hart, 1994; Dworkin, 1986).

Pressures in compliance are however real. Rationalist explanations focus on reputational and market noncompliance costs, whereas constructivist explanations focus on social learning and identity-based incentives. The FATF regime hypothetically works on both, such as the threat of listing and market exclusion offers material incentives, and mutual evaluation and the network of regulators can socialize domestic officials into common professional norms on a shared basis (Keohane, 1984; Simmons, 2010; Checkel, 2005).

Lastly, AML and CFT regulation dissemination is akin to a certain type of legal transplantation. Traditional literature on legal transplants cautions that imported rules can be detached to local institutional capabilities and social activities. Recent studies of diffusion emphasize the fact that transplants are not extensively reproduced, but are instead chosen, modified, and justified by local political spheres and transnational specialists. The ideas can be used to contextualize how AML and CFT reforms can create formal legal change without an equivalent enforcement capacity or without trust of the supervisory institutions (Watson, 1974; Morin & Gnanguenon, 2014).

4. Methodology and Materials

The article has adopted a mixed doctrinal and socio-legal approach. First, it engages in doctrinal examination of the FATF Recommendations, evaluation technique, and procedures tools that formulate mutual examinations and listing rulings. Second, it performs qualitative analysis of documents (texts on core implementation) (mutual evaluation reports, follow-up reports, and policy statements) to focus on the way of how evaluative categories and risk stories are formed and mobilized in practice (FATF, 2012; FATF, 2023; Hutchinson and Duncan, 2012).

Pakistan is the main case study due to its long-term FATF supervision and implementing extensive reforms in the framework of terrorist financing and money laundering action plans in 2018-2022. The main sources would be the mutual evaluation report of the APG, follow-up reports and reports on the reform track of Pakistan published publicly. To prevent overgeneralization, the article also presents short comparative articles of other jurisdictions that provide a description of variation in the paths off the greylist (APG, 2019; FATF, 2022).

The interpretive perspective of analysis is interpretive, as it does not view compliance as a dichotomous consequence, but as a negotiated category that is determined under evaluative standards, paperwork, and institutional pressures. This method is in line with the qualitative research direction that puts a lot of emphasis on the compatibility of the research questions, selection of cases, sources of data, and the interpretation of claims (Yanow, 1993; Saunders et al., 2007).

There must be limitations made in advance. The analysis will mostly use documents published publicly and thus it might not capture sensitive intelligence and informal bargaining in the ICRG process. The article does not purport to quantify real volumes of laundering and does not attempt to causally estimate the impact of certain reforms. Instead, it tries to describe institutional forces, simmering, and possible reforms that are based on evidence that is available.

5. Case Study: Pakistan's Grey-Listing and the Politics of Demonstrated Compliance

The case of Pakistan and the FATF is a good example of how the regime can shorten domestic reform agendas. In 2018, Pakistan was put on a higher level of monitoring and had to take up a time-limited action plan to balance failures in TF as well as ML controls later on. The 2019 mutual evaluation report of Pakistan that was incorporated into the APG framework revealed that it has serious weaknesses in effectiveness and coordination between competent authorities (APG, 2019; FATF, 2022).

As a reaction, Pakistan followed the policy of rapid legal and administrative transplantation. According to the accounts provided by the public on the period of reform, there were changes in the key laws, the regulation of DNFBPs, the increase in the level of interagency coordination, and the increased attention to specific financial penalties. A central component of Pakistan's compliance approach involved systematic evidentiary production, creating documentation that

would be able to meet the standards of FATF and APG evaluators both in the field of technical compliance requirements and effectiveness expectations (FATF, 2022; Financial Monitoring Unit Pakistan, 2023).

The case reflects the concept of situated agency in two aspects. To begin with, domestic players were not imitators of the FATF template; they were interested in reforms that were relevant to assessors, and which could be reflected in the assessment cycle. Second, the reforms passed through locally set legal and political restrictions such as the procedural assurances of the criminal process and the capacity limitation of the supervisory agencies. Such limitations defined the possible quickness of results, and which indicators of effectiveness could be more readily proved (Yanow, 1993; Yanow and Schwartz-Shea, 2014).

As of October 2022, FATF reported that Pakistan had fulfilled its action plans and it was taken off the list of jurisdictions subject to enhanced scrutiny. Follow-up reporting also indicated that there were great improvements in technical compliance ratings. The long-term effectiveness of those reforms will be determined by the process of institutional absorption: long-term supervision of DNFBPs, quality of financial intelligence, cross-border mutual legal assistance, and the credibility of enforcement against politically exposed or well-connected participants (FATF, 2022; APG, 2019).

Pakistan has both successes and continued struggles identified, as has been noted in scholarly work in the country and practitioner commentary, such as supervisory capacity, the burdens of coordination, and the danger that compliance becomes an externally imposed checklist instead of an internally owned governance project (IFAC, 2023).

6. Three Persistent Tensions in the Hybrid AML/CFT Order

6.1. Measuring compliance versus achieving outcomes

The initial tension is epistemic: evaluating each other is organized in terms of vast indicators of technical compliance and fewer immediate outcomes that are supposed to reflect effectiveness. Technical compliance is relatively quantitative: there are laws or no, supervisors have authorities or no, but effectiveness is determined by causal paths: law creation, capability in investigations, motivation of prosecutors, judicial congestion, and recovery of assets. Such discrepancy may generate motivation to focus on legal drafting and institutional form instead of durable capabilities (FATF, 2021; FATF, 2013).

Firsthand studies of AML and CFT implementation capture the concentration of compliance burdens in regulated institutions; supervisory models that are varied; and find effectiveness hard to discern even in high-capacity systems. In that regard, the fact that there are ambitious claims on how to reduce ML must be viewed as a hypothesis, not the proven results (Halliday and Shaffer, 2015; Zavoli et al., 2021).

6.2. Coercive market discipline versus procedural legitimacy

The second conflict is that of legitimacy. The listing of choices and follow up routes may have actual economic and political expenditure. According to IMF research, grey listing is linked to huge falls in capital inflows. But the governance procedures, which lead to listing or delisting, are not readily compatible with transparency, reason-giving and contestability norms of the public law. The recent international relations theory wonders whether the material logic of enforcement is sufficient in explaining the outcomes, implying that blacklisting and greylisting also act as symbolic cues whose operation might be uneven among the states (Zavoli et al., 2021; Sharman, 2011).

The legitimacy dilemma is intensified by the hybrid hardening, although the FATF itself may not require enhanced due diligence (EDD) of all counterparties in grey-listed jurisdictions, the response of private institutions is often to narrow risk appetites, increase costs, and terminate relationships. Procedural safeguards get more consequential in instances where downstream market discipline is applied as the major sanction (Halliday and Levi, 2014).

6.3. Risk-based regulation, de-risking, and inclusion

The third conflict is the issue of proportionality. The FATF supports a risk based approach (RBA), which theoretically may permit simplified responses to lower-risk circumstances. Practically, however, improperly executed RBA may increase the level of de-risking: banks end relationships with all types of customers (e.g., money service businesses, non-profit organizations, charities and donations) to avoid the compliance risk. FATF itself has recognized unintended consequences and started work streams on de-risking, financial exclusion, and undue constraints on civil society, which last more than a year (FATF, 2023; FATF, 2021).

It is not merely normative tension; it has to do with performance-based legitimacy. When the regime is judged by the easily observable results (e.g., suspicious transaction reporting volume) instead of the results (e.g., the disruption of the key criminal networks, recovery of meaningful assets, and anonymity), the risk of over-compliance and exclusion is increased. The quantitative legitimacy literature emphasizes the fact that we need to relate governance assertions to plausible performance indicators (FATF, 2021; Halliday and Shaffer, 2015).

7. Strengthening Legitimacy and Evidence without Weakening Standards

The effective implementation of the AML and CFT order relies on the capacity to align the expectations of different jurisdictions and market participants in part, and this should be reflected in the reform proposals. Any efforts to weaken convergence through reforms may compromise collective action. This is not the objective of deserting the integrated architecture, it is to mitigate its pathologies, through enhancing procedural legitimacy, evidence-based assessment and proportionality (Halliday and Shaffer, 2015; FATF, 2021).

7.1. Proceduralization and contestability in listing-related processes

To start with, further proceduralization of listing-related procedures should be made by the FATF and FSRBs. This involves better publication of appraisal standards, more orderly justification of major determinations and organized possibilities of jurisdictions to address the factual discoveries before public knowledge. The transparency of the process regarding timelines, the quality of evidence, and the channels of delisting would increase the legitimacy and the perceptions of politicization even in the areas where the ICRG process requires sensitive information (FATF, 2013; FATF, 2022; Halliday and Levi, 2014).

7.2. A more outcome-oriented evidence base

Second, evaluators ought to be more differentiated in terms of (a) formal legal transplants, (b) operational capacity, and (c) outcome indicators which realistically indicate disruption of illicit finance. Mutual evaluations participating in the FATF strategic review are now viewed as shorter-cycle and risk-based; the next measure is to create collective advice on how to interpret indicators of effectiveness in low-capacity and high-informality environments (FATF, 2021; Watson, 1974; Morin and Gnanguenon, 2014).

7.3. Mitigating unintended consequences and integrating inclusion considerations

Third, the mitigation of unintended consequences must be institutionalized in the reforms instead of it being considered as peripheral guidance. The current unintended consequences workstream of the FATF offers a normative foundation to the necessity of evaluators to examine whether the domestic application of the risk-based approach is causing unwarranted de-risking, humanitarian bottlenecks or excessive curtailment of civil society. In cases where these effects are recorded, assessors are supposed to offer calibrated recommendations that would maintain financial integrity and allow proportionate simplified actions (FATF, 2023; FATF, 2021).

7.4. Capacity-building that respects situated agency

Fourth, capacity building must be phrased in the terms of situated agency, as opposed to the technical assistance. This, in other words, implies that supporting jurisdictions in developing institutions capable of maintaining supervision and enforcement over a duration that does not only concern a single assessment cycle, particularly DNFBP supervision, beneficial ownership verification, and cross-border asset recovery, but which also provides room to tailor implementation strategies to the specific circumstances of each context. FSRBs are in a good position to promote peer learning in similar situation jurisdictions but should not imitate templates of one-size-fits-all (Keohane, 1984; Yanow, 1993; Halliday and Levi, 2014).

8. Pathways Through comparative perspective and Beyond Grey Listing

Despite the fact that the analysis is based on the Pakistan case, comparative perspective prevents the situation where the path of one jurisdiction is viewed as a typical one. The public listings of

FATF are reviewed thrice annually and demonstrate that the list of jurisdictions to which greater vigilance is given is dynamic, with new entrants and exporters (FATF, 2023).

The fact that South Africa and Nigeria fell off the grey list in October 2025 was largely viewed as a signal of investor confidence. It was also reported that the material stakes of listing decisions were of interest based on the IMF findings where grey listing was linked to significant falls in capital inflows. These incidences emphasize the ambiguity of the regime: official FATF messages are turned into trading practices (Zavoli et al., 2021; IMF, 2021). Thus, "beyond grey listing" should be understood not merely as delisting, but as the institutionalisation of AML and CFT reforms capable of sustaining compliance, enforcement credibility, and financial-system confidence after external monitoring decreases.

9. Conclusion

The AML and CFT regime of the FATF can best be viewed as a mixed transnational regulatory framework in which market discipline, multilateral conditionality and domestic-legal translation are used to harden its soft-law provisions. The regime reach and resilience is explained by hybridization, which also creates ongoing tensions, a propensity to reward measurable compliance as compared to outcomes difficult to detect; imbalance of legitimacy and accountability in listing-related processes; and proportionality issues regarding risk-based regulation and financial inclusion (Halliday and Shaffer, 2015; FATF, 2023).

The experience of the grey listing of Pakistan provides an insight into how jurisdictions can react on tight timeframes: developing legal and institutional transplants that meet the evaluative standards at the expense of balancing with local constraints. It is not the case that FATF pressure is ineffective; but instead, the fact that effectiveness relies on long-run institution absorption and readiness by the regime to tune evaluation towards results and proportionality (FATF, 2022; Morin & Gnanguenon, 2014).

Procedural contestability reform can enhance the evidence base of evaluating effectiveness, and mainstream reducing unintended consequences can promote the credibility of the regime without impairing global coordination. In a world where illegal finance manages to evolve quickly, the effectiveness of AML and CFT governance will be increasingly viewed in the principle of showing that rules are present, and they are functional, and that they are functional without a significant collateral damage (FATF, 2021; Zavoli et al., 2021).

Appendix A. Summary of Hybrid Governance Tensions and Reform Options

Table A1. Hybrid AML/CFT governance: key tensions and reform levers.

Tension	How it appears in practice	Risk	Reform lever (illustrative)

Compliance metrics vs. outcomes	Technical rules and documentation improve faster than investigative and recovery capacity.	Formal convergence without meaningful disruption of illicit finance; overemphasis on 'paper' compliance.	Sharper outcome indicators; differentiated expectations for capacity constraints; longer-horizon follow-up.
Market discipline vs. procedural legitimacy	Listing signals trigger private risk reactions even when formal requirements are limited.	Opaque processes generate perceptions of politicization; amplifies economic costs.	More systematic reason-giving; clearer criteria; structured opportunities to respond; transparency on timelines.
Risk-based approach vs. de-risking/inclusion	Banks exit customer classes or corridors; NPO/humanitarian constraints; exclusion of informal actors.	Financial exclusion undermines integrity and development; human rights and humanitarian spillovers.	Embed unintended-consequence review in evaluations; strengthen proportionality guidance; supervisory expectations against blanket de-risking.

Sources: FATF methodology and effectiveness synthesis; IMF grey-listing evidence; FATF unintended consequences work stream.

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