

## Appendix A

### SBP – Regulatory and Supervisory Developments in CY-2021

State Bank of Pakistan, as the regulator of key financial institutions and Payment Systems (i.e. Banks, MFBs, DFIs, Exchange Companies, Payment System Operators and Providers (PSOs/PSPs), and EMIs) plays a pivotal role in ensuring stability and development of the financial sector of Pakistan in a sustainable manner. With fast adoption of technology and new products, the financial sector has been growing in complexity and interconnectedness over the years. As such, this requires continuous efforts on the part of the regulator to mitigate the emerging risks from developments in the financial sector. To this end, SBP further strengthened its policy framework during CY21 and took various measures to mitigate the emerging systemic risks.

COVID-19 continued to pose challenges for various business sectors in Pakistan with multiple waves of infections from new variants of the virus – the financial sector was no exception to this. However, the financial sector proved resilient in the face of these challenges with effective policy support from the government and the regulator. Further, the financial institutions were also able to provide uninterrupted financial services to the customers despite the challenges caused by the pandemic. The challenges posed by the COVID-19 pandemic evolved over time and SBP revised its response accordingly. As the economy started on its path to recovery, SBP let some of its time-bound support measures to relapse. These measures included TERF, Loan Deferment and Restructuring Package, RFCC, amongst others.

However, COVID-19 also brought about a more permanent paradigm shift in the customers' preferences and pushed them toward digital financial services. This shift in preference as

well as trend of fast adoption of digital finance services were also supported by SBP through various measures to enable the banks to cater to the changing and increasing needs of the customers.

#### *Financial Stability – A Macro Perspective*

SBP realizes the crucial role that technological advancement can play in the development of the banking sector. As such, it encourages sustainable innovation and application of financial technology in banking. SBP undertook various measures during the year under review to provide an enabling regulatory framework for FIs. These measures include the development and launching of *Licensing and Regulatory Framework for Digital Banks* in Pakistan as a separate and distinct category in banking business in order to provide an enabling regulatory landscape for nurturing digital innovations while ensuring stability, safety and soundness of country's banking sector. The framework provides complete guidance regarding i)- licensing requirements and eligibility criteria for sponsors of digital banks, ii)- regulatory capital requirements, iii)- guiding regulations for digital banks, iv)- business operations allowed during different phases and v) list of documents required with the licensing application. It is expected that digital banks will be able to offer all kinds of financial products and services primarily through digital platforms or electronic channels instead of physical branches. This will help in promoting financial inclusion by significantly improving provision of access to unserved and underserved segments of the society in a cost effective manner.

Further, SBP also issued *Customers' Digital Onboarding Framework* to enhance the coverage of digital onboarding process and bring efficiency and effectiveness in the account

opening process using technology. This initiative is part of SBP's digitization efforts and it is expected to increase convenience for the customers to fulfil their financial needs through swift and secure digital infrastructure in Pakistan.

SBP always endeavors to update and enhance its supervisory regime to cope with emerging risks and challenges of the dynamic banking system. In this regard, SBP successfully rolled out *Risk Based Supervisory Framework* with the aim to align it with good international practices.<sup>217</sup> Being a forward-looking framework, it will help better understand the risk profiles of regulated entities with respect to both external and internal risks and controls. This will facilitate supervisors in early identification of problems, efficient deployment of supervisory resources and initiating prompt corrective actions. Accordingly, on-site and off-site supervisory departments were restructured to achieve the core objectives of RBS framework.<sup>218</sup>

SBP supports the Government of Pakistan's (GoP) economic policies to foster development and ensure fuller utilization of resources. Accordingly, SBP, in 2020, had supported GoP in providing markup subsidy for housing finance in order to provide formal financial services to the people of Pakistan at affordable rates. During 2021, SBP revised features of *Government's Markup Subsidy Scheme for Housing Finance* to align it with market dynamics. These revisions aim at significantly enhancing outreach of the scheme to individuals and households who currently do not own a house. SBP also developed a mechanism for payment of markup subsidy and shared it with FIs working as Executing Agencies (EAs) for the subject facility.<sup>219</sup> Furthermore, SBP assigned monthly mandatory targets of number of housing units and amount of disbursements to banks in proportion to

share in total banking assets. SBP also issued *Guidelines for financing of housing units in under-construction projects*.<sup>220</sup>

SBP in collaboration with GoP launched *SAAF Scheme* during the year under review. The scheme provides a unique facility, wherein, refinance is provided by SBP while risk coverage of up to 60 percent is provided by the GoP. This scheme addresses the issue of lack of collateral, and also aims at increasing financial inclusion of SMEs. Under SAAF, SMEs can avail collateral free financing of up to PKR 10 million to meet their long term capital expenditures and short term working capital needs. SBP is providing liquidity to participating banks at 1 percent per annum (p.a.) for onward lending by banks to SMEs at a concessional end user rate of up to 9 percent p.a. The end user rate under SAAF is very attractive when compared with SMEs' financial cost for availing financing from informal sources.

The central bank conducts SRS on a biannual basis to gauge and assess the views of the market participants and independent experts about the emerging risks and effectiveness of its policy framework. In this regard, the 7<sup>th</sup> and 8<sup>th</sup> waves of the survey were conducted during the year under review, while the 9<sup>th</sup> wave of the survey was conducted in Jan-22 (results of the 9<sup>th</sup> wave are given in Box 1).

As part of its efforts to share information and contribute to various regional and international studies, SBP provided its feedback on various international surveys and questionnaires. SBP also participated in FSB Regional Consultative Group for Asia (FSB RCG Asia) conference calls where vulnerabilities and financial stability issues affecting Asia were discussed, along with other emerging issues. These issues included regulatory and supervisory challenges arising from COVID-19, and outsourcing and third party relationships for the conference calls held

<sup>217</sup> SBP's [Risk Based Supervisory Framework – July 2021](#)

<sup>218</sup> [OSD Circular No. 02 of 2021](#)

<sup>219</sup> [IH&SMEFD Circular Letter No. 03 of 2021](#)

<sup>220</sup> [IH&SMEFD Circular No. 10 of 2021](#)

in 2021. SBP also played the role of a lead speaker in one of the RCG Asia Conference Calls on invitation and shared its experience and insights on its policies on outsourcing to **CSPs** by the financial institutions.

#### *Financial Stability – A Micro Perspective*

*Regulatory and Supervisory Oversight:* SBP formulated a comprehensive *Corporate Governance Regulatory Framework (CGRF)* for financial institutions to further strengthen the corporate governance regime and to align the same with international standards/principles. The salient features of the CGRF include strengthening and rationalizing Fit & Proper Test (**FPT**) Criteria for all categories of persons subject to FPT assessment, enhancement of the role of financial institutions in FPT assessment by introducing the requirement of Standard Operating Procedures (**SOPs**) for self-assessment, empowerment of the Board of Directors through enhancement of their roles and responsibilities related to overall governance of the financial institution, and alignment of the corporate governance requirements with international standards/principles.<sup>221</sup>

The National ML/TF Risk Assessment of Pakistan – 2022 (**NRA-22**) is currently underway and SBP is member of a national level core committee for review and guidance on NRA-22. With respect to NRA-22, SBP conducted a comprehensive assessment of inherent ML/TF (Money Laundering & Terrorism Financing) vulnerabilities of SBP regulated sectors i.e. Banks, MFBs, Exchange Companies and DFIs. Moreover, SBP updated its ML/TF risk assessment methodology in light of findings of the previous National ML/TF Risk Assessment. Correspondingly, penalty scale for AML/CFT delinquencies was also updated and made risk-sensitive.

<sup>221</sup> [BPRD Circular No. 05 of 2021](#)

<sup>222</sup> CRR is the amount of money that banks are required to keep with SBP; it is applicable on demand liabilities and

SBP relaxed the criteria for assets and provisioning requirements for Deferred and Restructured Portfolio (**DRP**) in order to enable MFBs to extend relief measures to affected borrowers. As a result of this measure, DRP loans would be classified if overdue by sixty days instead of thirty days. However, this was a time-bound measure available for DRP only up till March 31, 2022.

With the economy recovering briskly from the severe shock of COVID-19 pandemic, there was a need to gradually normalize policy settings, including the growth of monetary aggregates. Real money supply growth had drifted above its trend following the COVID-19 shock. Accordingly, SBP decided to increase the average CRR, to be maintained during a period of two weeks by scheduled banks, from 5 percent to 6 percent and minimum CRR to be maintained each day from 3 percent to 4 percent.<sup>222</sup> This measure was taken to moderate the growth of real money supply as well as domestic demand, thereby helping to sustain the current economic recovery, achieve the government's medium-term inflation target, and reduce pressures on the Rupee.

SBP took various initiatives to enhance digitization initiatives in FIs. In order to shape a proper governance structure for digitization, FIs currently offering or planning to offer digital financial services were instructed to create a role of Chief Digital Officer or a similar role with a different designation. The officer should preferably be a Key Executive responsible for steering the digitization efforts of the organization. In addition, accelerated digitization should also be part of every CEO's Key Performance Indicators (**KPIs**) and the board of the FI should monitor the achievements at least on half-yearly basis. Other instructions, in this regard, include those regarding internet banking and mobile banking,

time liabilities with tenor of less than a year. Time liabilities with tenor of more than one year shall continue to be exempted from maintenance of CRR.

deployment of interoperable CDMs, a card per account policy, and digital means of authentication at bank counters.

SBP had developed and rolled out the Regulatory Approval System (**RAS**) in 2020 to strengthen the organizational efficiency and effectiveness.<sup>223</sup> RAS provides an online platform to Authorized Dealers (**ADs**) to interact with the regulator for submission of cases and receive regulatory decisions against them. In the first phase, the digitization process of Foreign Exchange Operations Department (**FEOD**) and Exchange Policy Department (**EPD**) were completed and they started functioning smoothly. After the successful launch of RAS for FX related cases, digitization of RAS for Banking Policy and Regulation Department was completed and rolled out for industry wide implementation in Nov-21.<sup>224</sup>

SBP also took several measures including, standardization of digital banking fraud reporting, awareness campaigns, issuance of regulatory instructions, close monitoring and engagement with FIs where digital banking frauds are in surge, thematic fraud inspections and improved collaboration with other regulatory bodies in the wake of rising number of digital banking frauds.

*Financial Inclusion:* SBP has been working on making financial services accessible to all including the poor and marginalized groups. Accordingly, SBP, in the year under review, prepared and launched *Banking on Equality Policy: Reducing the Gender Gap in Financial Inclusion* after consultation with relevant stakeholders to enhance women's financial inclusion. The policy is based on the premise that gender-neutral policies in the financial sector have been insufficient to reduce the gender gap in the financial sector and there is a pressing need to view financial sector policies

through a gender lens.<sup>225</sup> Further, the presence of women BB agents is essential to aid women's adoption of digital financial services, especially in rural areas. However, currently only 1 percent of BB agents are women. Therefore, SBP also introduced various measures to improve ratio of women BB agents in FIs.<sup>226</sup>

SBP has been issuing instructions from time to time to make financial services accessible to Persons with Disabilities (**PWDs**). In order to better facilitate PWDs and provide detailed regulatory guidance, SBP, during the year under review, developed a comprehensive policy framework to promote financial inclusion of PWDs.<sup>227</sup> PWDs normally face severe limitations while accessing financial services offered by FIs because of a combination of physical constraints and perceptions about their abilities to handle financial matters. SBP undertook this initiative seeing the need to make banking easy and convenient for them through supportive physical infrastructure, accessible products and services, assistive technologies, and supportive staff interactions. Further, provincial and federal laws also prescribe a minimum percentage of PWDs to be employed which needs to be properly implemented in financial institutions.

SBP has also been working on accessible financial infrastructure for differently-abled persons as well. As part of this work, SBP, in consultation with stakeholders, decided to facilitate them with regard to opening and maintaining a bank account as per the applicable laws related to mental health. Accordingly, a new category of customer account was introduced for persons facing mental disorder in Jun-21 and the related requirements were made part of Annexure-II of the AML/CFT/CPF Regulations. The banks were advised to ensure compliance and provide

<sup>223</sup> [EPD Circular Letter No. 08 of 2020](#)

<sup>224</sup> [BPRD Circular No. 04 of 2021](#)

<sup>225</sup> [AC&MFD Circular No. 1 of 2021](#)

<sup>226</sup> [BPRD Circular No. 03 of 2021](#)

<sup>227</sup> [BC&CPD Circular No. 05 of 2021](#)

proper guidance to their customers so that the court-appointed managers of such persons do not face any difficulty in this regard.<sup>228</sup>

SBP also launched Asaan Mobile Account **(AMA)** during the year under review. The initiative was developed under the National Financial Inclusion Strategy with the objective of bringing further ease in remote account opening under branchless banking. The customers would be able to open and operate their accounts from the comfort of their homes, without having to visit the branches, with any of the participating branchless banking providers. The solution has been developed through collaboration of SBP, PTA, National Database and Registration Authority **(NADRA)**, 13 BB Providers, all Cellular Mobile Operators **(CMOs)** and Virtual Remittance Gateway **(VRG)**. For AMA, the branchless banking providers and cellular mobile operators are collaborating to deliver an interoperable platform, allowing any Pakistani to open an account with a bank. AMA will play a crucial role in reaching out to the low-income segments that do not have access to internet. Moreover, it will facilitate onboarding of women customers.<sup>229</sup>

*Protection of Depositors:* Deposit insurance system is a key element of any modern supervisory and crisis management framework. It protects the interests of small depositors in case of bank failures and supports financial stability by promoting general public's confidence in the banking system. In order to further safeguard depositors' interests and enhance their trust in the country's banking system, SBP (through its subsidiary Deposit Protection Corporation), decided to enhance the level of protected deposit from PKR 250,000/- to up-to PKR 500,000/- per depositor-per bank. Under the provisions of section 7(1) of DPC Act 2016, the Corporation shall guarantee full payment of funds held in

depositor's account, up to an amount prescribed by the Corporation from time to time.<sup>230</sup>

*Banking Conduct and Consumer Protection:* An effective consumer protection and fair conduct regime is essential for preserving the trust in financial system and promoting its growth on a sustainable basis. In this regard, SBP recognizes that effective and efficient Consumer Grievance Handling Mechanism **(CGHM)** is a crucial element of Fair Treatment of Consumer **(FTC)** regime. As such, SBP has taken various measures and issued guidelines to enhance responsible complaint handling by the FIs over the time. Similarly, SBP had also formulated and rolled out the *Conduct Assessment Framework (CAF)* in 2016. During the year under review, SBP conducted a detailed review of complaint handling practices at financial institutions focusing on the qualitative aspects of 'ease of complaint lodgment', 'capacity and resources', 'recording and processing', and 'monitoring'. Following this exercise, SBP issued a number of instructions to further enhance consumer complaint handling mechanism in the financial institutions. These instructions included availability of mandatory modes (call centers, email, E-form, etc.) for complaint lodgment at all times, encouraging financial institutions to invest and focus on innovative modes of complaint lodgment, provision of complaint tracking number through SMS and emails among others. Further, the regulatory returns template prescribed earlier by SBP was also revised in light of the need for improved data quality and industry feedback.<sup>231</sup>

As financial institutions and customers move towards digital financial services, various unscrupulous elements looking for new avenues of profit are also turning their attention towards this sector. Digital banking frauds are mostly conducted by employing social engineering tactics including fake calls.

<sup>228</sup> [BPRD Circular Letter No. 20 of 2021](#)

<sup>229</sup> [SBP Press Release](#) dated December 12, 2021

<sup>230</sup> [DPC Circular Letter No. 01 of 2021](#)

<sup>231</sup> [BC&CPD Circular Letter No. 02 of 2021](#)

SBP, in consultation with various stakeholders, has taken various measures to curtail these frauds. Further, SBP also issued standardized formats to collect information on digital banking frauds through call centers. This information will help in successfully designing and deploying additional measures. FIs were advised to ensure that the call center agents are sufficiently trained to handle calls received for reporting digital banking frauds. They must be capable of identifying attempted digital banking fraud-related calls when a naive customer unaware of fraudulent attempt reports such instances. FIs were also instructed to report the relevant information to PTA for blocking SIM/device of the fraudsters used for committed/attempted digital banking frauds as soon as identified. Further, as a control mechanism to avoid any further financial loss, the call agents upon receiving calls for blocking digital channels/cards in case of fraud will immediately block all channels temporarily, under intimation to the customer, before seeking detailed verification from the customer. SBP also conducted a thematic review to assess the call center management of financial institutions and issued revised and consolidated regulatory instructions on call center management.<sup>232</sup>

*Payment Systems:* SBP took various measures to improve the digital payment services landscape and promote digitization of payment transactions in the country. SBP launched the first phase of Raast as Pakistan's first instant payment system to further promote digital financial services and financial inclusion. Raast enables end-to-end digital payments among individuals, businesses and government entities instantaneously. SBP believes that the launch of Raast-P2P service will not only provide a convenient and hassle free digital fund transfer service to customers but will also provide an efficient and enabling payments infrastructure that would pave the way for digitization of the

economy. Bank customers can set their registered mobile phone number as their Raast ID and link it to their preferred IBAN using the bank's mobile application, internet banking, or visiting their bank branch. Once a customer has set her/his mobile phone number as the Raast ID, others can send money to her/him using her/his mobile phone number without the need to know the account number or any other details.

Since its launch on September 10, 2020, RDA has attracted significant interest from overseas Pakistanis. In line with SBP's commitment to transparency in its key policy measures, SBP started releasing regular data on the progress of RDA. Based on individual reports of banks that participate in RDA, the data has been consolidated and made available to the public through a new web page. This web page is updated on a monthly basis which was also requested by market participants.<sup>233</sup>

*Foreign Exchange Policy and Operations:*

External account stability is a key point for both financial and economic stability of the country. In an effort to support the balance-of-payments, SBP decided to impose 100 percent CMR on import of further 114 items, taking the total number of items subject to Cash Margin to 525 by the end of CY21. The measure will help discourage imports of items subject to CMR and thus support the balance-of-payments. Earlier, SBP had also revised prudential regulations for consumer financing prohibiting financing for imported vehicles.

In an effort to enhance documentation and transparency and to further strengthen the foreign exchange regulatory regime, SBP amended the regulations governing sale of foreign exchange to individuals by exchange companies. This step, which is in continuation of other measures taken by SBP, is primarily to discourage speculative buying and selling of foreign exchange from the exchange companies

<sup>232</sup> [BC&CPD Circular No. 03 of 2021](#)

<sup>233</sup> [SBP Press Release](#) dated July 3, 2021

without affecting the ability of the market to serve the genuine needs of the public. Consequent to these amendments, exchange companies shall ensure that any individual shall not purchase foreign exchange from all exchange companies in excess of USD 10,000 per day and USD 100,000 (or equivalent in other currencies) per calendar year, in the form of cash or outward remittances. These limits have been set taking into consideration the individual's personal needs for foreign exchange.

Sohni Dharti Remittance Program was inaugurated during the year under review which is offered jointly by SBP, Ministry of Finance and financial institutions. SDRP is an innovative program designed to incentivize Pakistani workers abroad to send remittances through banks and exchange companies and earn reward points. These reward points could then be used to avail different benefits offered by partner organizations. The services offered include international tickets by Pakistan International Airlines (PIA) and the provision to pay for extra luggage on international flights of PIA. SDRP can be accessed conveniently from anywhere in the world through a mobile application. SDRP is another step towards digitalization and financial inclusion that would play a significant role in digital onboarding of Overseas Pakistanis and their beneficiaries in Pakistan.

*Islamic Banking:* As the size of the Islamic banking industry is increasing and now comprises of a significant share of the overall banking industry, SBP recognized the need to introduce Shariah compliant liquidity facilities for IBIs. With a view to bring IBIs at par vis-à-

vis their conventional counterparts in terms of liquidity management avenues, and to enhance SBP's tools for managing market's liquidity as part of its monetary policy objective, SBP introduced *Shariah Compliant Standing Ceiling Facility-Mudarabah Based Financing Facility* and *Shariah Compliant Mudarabah Based OMOs-Injections* for IBIs.<sup>234</sup> SBP has also introduced regulations for LOLR facility, which also includes financing for Islamic banking institutions under Shariah-compliant mode.

SBP issued a set of exclusive instructions on SNCR management, aimed at enhancing the stability and soundness of Islamic banking sector. It is important to highlight that these instructions are in addition to the existing comprehensive Shariah governance framework, which is already in place for Islamic banking institutions.

SBP also made some amendments in the Shariah Governance Framework for Islamic Banking Institutions.<sup>235</sup> As per the amendments, the Shariah Board members, except Resident Shariah Board Member (**RSBM**), may serve on the Shariah Boards of up to three IBIs in Pakistan. However, the IBI must ensure that its Shariah Board has at least two members (other than RSBM), who are not on the Shariah Board of any other IBI. Hence, each IBI will have at least three unique members in Shariah Board including RSBM. The revision - effective from July 1, 2021 - was aimed at enhancing pool of Shariah Scholars in the Islamic banking industry and providing flexibility to IBIs to have Shariah Boards with diversified experience and exposure.

<sup>234</sup> [SBP Press Release](#) i.e. SBP introduced Shariah Compliant Liquidity Facility dated December 29, 2021

<sup>235</sup> [IBD Circular Letter No. 01 of 2021](#)