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STATE BANK OF PAKISTAN

Contents

THE NATIONAL PAYMENT SYSTEMS STRATEGY

INTRODUCTION

Financial Market Infrastructures (FMIs) that facilitate the clearing, settlement, and recording of monetary and other financial transactions can strengthen the markets they serve, play a critical role in fostering financial stability and hence contribute to a strong economy. Central banks typically seek efficiency and safety in the National Payments System (NPS), including retail payment systems, services and payment instruments. More recently, accessibility, the effective protection of customers and the existence of a competitive environment are also being considered as important objectives by many central banks.

The objectives of this National Payments System Strategy are to make recommendations to design a National Payments System complying with international standards and best practices, and tailored for the specific circumstances and needs for a safe, efficient and inclusive National Payment Systems in Pakistan.

Migration to efficient electronic payments stimulates consumption and trade, bringing benefits to the whole economy. By migrating to electronic means, the strategy intends to boost Pakistan's GDP by 7%, creating 4 million jobs, resulting in $263 billion in new deposits, representing a potential market of $36 billion, all by 2025. Furthermore, financial market infrastructures that facilitate the clearing, settlement, and recording of monetary and other financial transactions can strengthen the markets they serve, play a critical role in fostering financial stability and hence contribute to a strong economy.The dual objective of enhancing financial stability to contribute to economic growth and of supporting financial inclusion are the overarching goals that guide the recommendations presented in this document.

The strategy for Pakistan's National Payment System is based on applicable international standards, particularly the CPMI-IOSCO PFMIs, as well as the analytical framework defined by the CPMI-World Bank for Payment Aspects of Financial Inclusions (PAFI). The foundations – commitment from stakeholders, the legal and regulatory framework, and financial and ICT infrastructures – are the critical enablers for payment systems and the provision of payment services in general. Specifically, they are important for the access to and usage of transaction accounts. Based on these, the catalytic pillars – i.e. payment product design, the ease with which accounts can be used, financial literacy, and leveraging large-volume recurrent payment streams for financial inclusion purposes – form the drivers for access and usage.

The strategy addresses a wide range of topics covering the entire National Payments System: the critical foundations, including the Legal and Regulatory Framework and the NPS Infrastructure. The strategy then continues with the characteristics of Pakistan's Retail Payments Market, the issues of account and payment product design, and access points. Oversight of the National Payment system is specifically identified as a key area of focus and a pivotal responsibility of the Central Bank. Finally, large-volume recurrent payment streams are identified and recommendations on how to leverage them are provided, starting with government payments and ending with national and international remittances.

PAKISTAN'S CURRENT STATE

Overall, cash still dominates the Pakistan economy. There is very little use of electronic payments, regardless of the value of the transaction, especially by micro and small retailers. Cash is the dominant payment method as it is considered "safe" by almost all the retailers and suppliers. Most wages and salaries are paid with cash. Cheques are widely used to make commercial and government payments.

The financial digital ecosystem is severely underdeveloped, both on the issuance and acceptance side. It will be difficult for the move to electronic payments to reach a critical mass without leveraging large recurrent payment streams such as government payments. As of 2019, only 21.3 percent of all adults in Pakistan own a transaction account; of these only 7 percent are held by females.

From this base, Pakistan has been proactive by triggering a transformation process, specifically through the introduction of “Branchless Banking” and the willingness of the SBP to engage in developing a new National Payments System strategy. Even though positive changes have been noted, the pace of transformation has been slow, and Pakistan still trails other countries with similar macroeconomic profiles.

The existing impediments revolve around the lack of the infrastructure needed to keep up with the widespread use of electronic payments, particularly for large volume payments (e.g. government payments). Specifically, by expanding the market and the legal/regulatory environment, approximately 69.3 million adults can be provided with transaction accounts, while an additional 9.2 million adults can obtain access to transaction accounts through the implementation of a financial inclusion strategy in Pakistan. Moreover, by digitizing G2P cash transfers, as much as 3.4 million adults can become recipients of electronic payments. On the demand side, there is a huge discrepancy between the fast pace at which financial inclusion has been progressing in other similar countries and the slower pace at which it has been progressing in Pakistan.

Key infrastructures include an interbank system for retail electronic funds transfers, i.e. an Automated Clearing House (ACH), a payment card processing platform or platforms, i.e. a payments switch, and a large-value interbank settlement system, i.e. a Real-Time Gross Settlement system (RTGS), a robust communications infrastructure and an effective and efficient identification infrastructure. Absence of any of these infrastructure components hinders the national payment system from exploiting the potential benefits of modern payment instruments, and therefore adversely affects financial inclusion. While Pakistan has a functioning RTGS named Pakistan Real-time Interbank Settlement Mechanism (PRISM) and a private switch (1Link), there is no ACH available.

Large-volume recurrent payment streams can be leveraged to advance financial inclusion objectives through various channels. They can be leveraged to drive investment in core retail payments infrastructure as well as in distribution channels and in the development of new payment products and services.

Government payment programs, especially benefit programs, have the potential to directly advance financial inclusion by providing transaction accounts and by stimulating greater investment in the infrastructures and networks necessary to support those accounts. By far, public administrations constitute the single largest user of payment services. Remittances, both cross-border and domestic, are another type of large-volume and recurrent payment stream that can be leveraged to advance financial inclusion. As well, Pakistan Post is one of the actors that presents a high potential in terms of payments modernization and coordination with other stakeholders (public and private) in the process.

While interoperability has made substantial progress in Pakistan, it will remain a limitation when over-the-counter transactions are predominant. This will require the full support and adherence of stakeholders, so as not to alienate their development plans. In the absence of interoperability amongst m-Wallets, agents are required to maintain separate m-Wallet accounts with each of the providers and, in some cases, must have separate mobile phones for different service providers. Agent-supported / over-the-counter transactions constitute the dominant model for mobile money in Pakistan.

Overall, while Pakistan has made substantial progress in developing its digital payment ecosystem, further effort is necessary to reach the scale necessary to transform the heavily cash-based economy to one where the efficiencies of digital payments are realized.

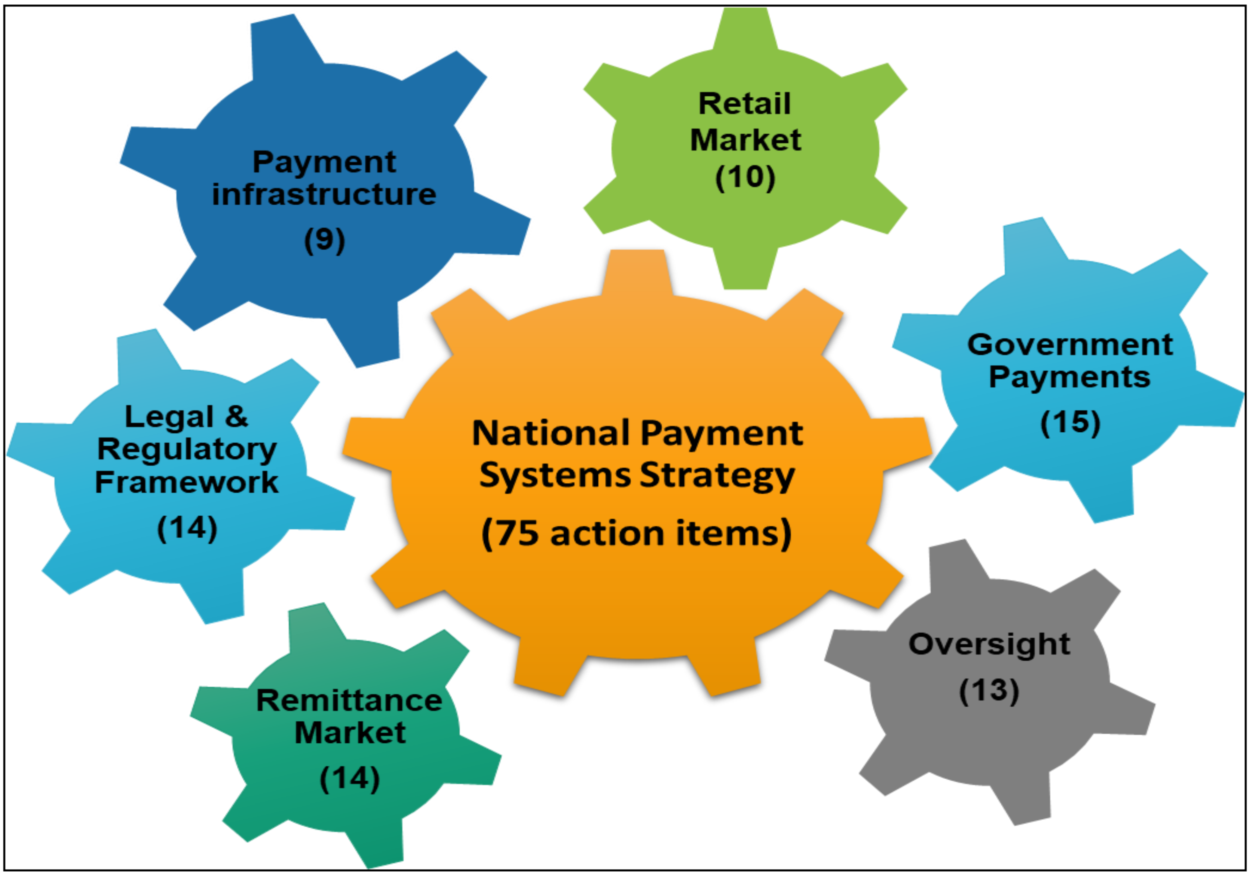

Figure 1-Summary of action items

LEGAL AND REGULATORY FRAMEWORK

The legal and regulatory framework plays a critical role in creating an enabling environment for inclusive payment services. In Pakistan, the definition of payment schemes is broad, but has several references to card schemes and focuses exclusively on banks and regulated financial institutions. As authorized by PS&EFT Act 2007, SBP issued Regulations for Electronic Money Institutions (EMIs) in April, 2019 and is presently in the process of licensing new EMIs. Issuance of EMI regulations has given clarity to the concept of e-money.

Currently, only designated payment systems and instruments are subject to comprehensive SBP's oversight. The safety and efficiency of the NPS requires monitoring of all relevant actors in the market, including those not traditionally overseen. As such the scope of the SBP oversight should be broadened to encompass all payment systems, payment instruments and services in the country including electronic money, beyond designated payment systems and instruments. The SBP should classify all payment systems operating in Pakistan as DPSs, with each payment system and instrument being designated specifically. This includes the payment activities of the Pakistan Post, as Pakistan Post provides domestic and international remittances (paying money received from abroad to Pakistan under a special agreement with Western Union) and collects payments on behalf of billers, and taxes, fees and fines on behalf of the federal and provincial government.

Once a PSO is designated and overseen by the SBP, legal provisions make its operational rules fully enforceable against third parties, including in special situations such as insolvency of the operator or one of its partners. In fact, designation will provide legal certainty around key provisions like finality, irrevocability, netting and its powers of oversight. Without such legal underpinnings, net obligations may be challenged in judicial or administrative insolvency proceedings. It is also recommended that existing payment instruments in use in Pakistan be classified as Designated Payment Instruments

(DPIs). Doing so would provide legal certainty around key provisions like finality, irrevocability and its powers of oversight.

Separate frameworks for Branchless Banking and other payment services should be avoided. Market competition and level playing fields are critical to establishing an enabling environment for the provision of inclusive retail payment services. A consistent regulatory and oversight framework for all payment services is necessary to ensure a level playing field between banks and licensed non-bank institutions.

The establishment of a National Payments Council / Committee is recommended. This Council would advise the SBP on its functions over the NPS, and permit coordination of action between public and private sectors to ensure the efficient and consistent implementation of SBP measures.

In an effort to promote objective, non-discriminatory and proportionate access to payment systems, all PSOs should include in their rules provisions that make access to the relevant system objective, non-discriminatory and proportionate. This should include Central Bank run platforms like PRISM. In this regard, the SBP should be explicitly recognized with the power to sign memoranda of understanding (MoU) with other regulatory authorities, provide a consumer protection mandate, and engage in system rule definition.

For Agents, a comprehensive regulation is necessary. Focus should be made towards liberalizing agent eligibility requirements, recognizing that overly restrictive policies can constrain efforts to expand financial inclusion while defining minimum requirements and other necessary criteria. SBP should maintains a public register of selected agents. Eliminate the possibility to limit the extent of bank liability for any act of their agents.

Approaches to KYC and CDD should be applied consistently across payments services and types of transaction accounts. A consistent approach across payments services and types of transactions is necessary.

Recommendations

- Review the draft Designation framework of payment systems to guarantee that it is fully in sync with the provisions of the PSEFT Act to ensure settlement finality and insolvency remoteness of collateral are made applicable to all DPSs
- Classify payment instruments as DPIs as stipulated in the PSEFT Act; Obtain legal opinion whether cheques also should be classified as DPIs under the PSEFT Act notwithstanding them being defined under the Negotiable Instruments Act.
- Enhance and revise the draft oversight policy framework:
  - Expand the scope of oversight to include securities settlement systems (DEPO-X (now known as TMSX) Government securities settlement system) and outline the nature of the oversight activities and the tools to be used;
  - Deal with retail payment instruments including alternate delivery channels in a separate section;
  - Elaborate on catalyst role of SBP in ushering in payment system reforms.
- Development of a cooperative framework for guiding the national payment system development in Pakistan comprising amongst others:
  - Establishing a high-level internal inter-departmental coordination committee to facilitate internal cooperation between the relevant departments in the SBP with a clear recognition of the role of the PSD as an overseer
  - Creating an internal inter-departmental committee to focus on, amongst other areas, Branchless Banking; oversight of DEPO-X (CSD and SSS)
  - Ensuring inter-regulatory cooperation between SBP, Securities regulator and the Telecom regulator

- Expanding the scope of MoU between SBP and Securities regulator to cover all facets contributing to the safe and efficient functioning of the FMIs in Pakistan;
- Developing a national permanent consultative body chaired by the Governor and the SBP, comprising all stakeholders (regulators, market infrastructures, non-bank payment service providers, participants including the Government) to prepare a strategic and holistic action plan with defined timelines for the modernization and development of payment and settlement systems Pakistan in keeping with international standards in a collaborative framework.
- Enhance data collection and analysis to aid in policy making and transparency and increasing customer awareness and knowledge.
- Complete the self-assessment of PRISM and DEPO-X using the Disclosure Framework and Assessment Methodology of the PFMIs

NATIONAL PAYMENTS SYSTEM INFRASTRUCTURE

Large Value Payments

Since 2008, Pakistan's RTGS, PRISM, processes transactions daily to speed up the settlement process and to limit interbank exposures. While an upgrade of the existing PRISM system was undertaken by SBP in 2017, introducing an updated securities settlement platform, automated intraday liquidity facility and other scalability updates, there are other challenges that needs to be addressed including the adoption of the ISO standard 20022.

SBP in 2018, issued revised PRISM Operating Rules that addresses a number of recommendation including the access criteria, however SBP may continue to review these rules periodically. Moreover, majority of the banks have already integrated their core banking system with PRISM for certain type of customer transactions, however, SBP may make it mandatory integration for all customer payments. The speed of processing payments would increase, and the risk of errors would diminish if the core banking applications of banks were linked to the PRISM interface.

Electronic Retail Payments

Electronic Payment Instruments

To move from the present domination of cash and cheques in Pakistan, the use of electronic payment instruments should be encouraged. Electronic payments via either credit transfers or Interbank Funds Transfers are available in Pakistan and can be accessed through various channels like branches, ATMs, Internet, mobile phones. However, their reach is very limited for repetitive payments such as salary payments, reimbursements of loans, and payment of insurance premiums, electronic payments are not readily used. These payments are mostly settled in cash or by cheque.

Card payments are under-developed in Pakistan, even though ~25 million debit cards have been issued mostly under Visa and Master card brand name are used to withdraw cash from ATMs. There are about 1.6 million credit cards that are mostly used on POS terminals. On average there is around 3 POS transaction per annum per scheme issued card. In 2016, 1Link launched PayPak, a domestic card scheme for the country. The scheme offers lower merchant discount rates than Visa and MasterCard, but this may not be sufficient to foster the use of cards unless a very ambitious policy is put in place by banks and merchants' organisations to facilitate the installation of POS terminals.

Each of these different payment solutions have been developed on an ad-hoc basis and in an un-coordinated way. This includes m-wallets (within the framework of Branchless Banking), the Pakistan Remittance Initiative, the PayPak card scheme. Because each of these initiatives entails its own instruments, procedures and infrastructures, the National Payment System of Pakistan appears very fragmented and therefore relatively inefficient.

Stakeholders would benefit from the development of a coordinated NPS with a new technical architecture that allow payers to freely select the most efficient payment instruments to transfer funds to beneficiaries anywhere in the country.

Infrastructure for Electronic Payments

1Link

Originally 1Link and M-net were switches which ran the networks of ATMs. Progressively the services offered by 1Link have been enriched, either by extending the services offered at the ATM level (bill payments for example), or by clearing new types of payments, such as those stemming from banks participating in the Pakistan Remittance Initiative or from Branchless Banking customers issuing credit transfers out of their m-wallets. The IBFT service (130,000 operations per day) offered by 1Link now allows bank customers to issue credit transfers from several access devices (ATM, mobile phones, Internet, call centres). 1Link also clears and settles payments between cardholders and merchants in PayPak. Recently, M-net has decided to close down its operations due to very limited participation and took a seat on the BoD of 1Link. .

The 1Link system allows for payment transactions to be credited real-time between the payer and the payee, 24 hours a day and 365 days a year. However, the underlying interbank transactions were settled only on T+1 in SBP’s books. This meant that the bank of the beneficiary credits its client long before it receives the cover from the bank of the payer thus exposing the beneficiary banks to unlimited liquidity and credit risks in the absence of a proper risk management framework. SBP addressed this risk by moving 1Link settlement to RTGS in 2018. Now 1Link sends multilateral net settlement batches 3 times a day to SBP’s RTGS which has significantly reduced the settlement exposures.

1Link has progressively increased the scope of its activities: it now plays a major role in the market infrastructure in Pakistan. The company is owned by a group of banks which has grown over time. Some non-bank participants, including telecommunication companies have expressed their concerns that governance of 1Link poses conflict of interest as their requests are often disregarded, or unduly postponed, when the changes could harm owner bank’s profitability. 1Link does not intend to open their shareholding substantially and only plan to become a private limited company, to allow some of the existing shareholders to exit. SBP should consider using its oversight mandate or discussing with competition authorities in Pakistan how to lead 1link to open its shareholdings or at the least to better take into consideration demands from non-shareholder participants.

Interoperability

Interoperability has already been achieved through the connection of all Branchless Banking networks to 1Link. Interoperability on the telecommunication side for access to USSD networks remains blocked by telecom operators. This now hampers further development as banking agents must hold a bank accounts with all relevant banks and make frequent liquidity transfers between them. There is a need for finding a solution on the telecom side, including a common national USSD code and a common gateway.

Future Architecture

New faster payments solutions have recently developed around the globe that functions 24 hours a day, 365 days a year and settle payments, or group of payments, in real-time on a gross basis. Real-time Retail Payment Systems (RRPS) have made it possible thanks to progress in technology to allow thousands, even millions of payments to settle in real-time or close to real-time all in a single system. Most countries that have developed a RRPS still rely on their ACH for the bulk of their transactions, relying on the RRPS for specific use cases. A modern NPS in Pakistan should involve two functionalities: an ACH functionality and an RRPS functionality. There is no ACH in Pakistan yet;

however, the IBFT functionality of 1Link offers limited RRPS services to a very small segment of the population which is not sufficient.

Recommendations

- The SBP should take the initiative of setting up an ACH in Pakistan, primarily for recurrent and non-urgent credit transfers and direct debits, through the implementation of an ATS. The ATS would be used for credit transfers (both large-value/critical through the RTGS functionality and batch/retail through the ACH functionality, especially for Government payments), direct debits, settlement of exogenous systems.
- The proposed Micro Payment Gateway (MPG) would be used for faster processing and settlement of retail transactions originated by banks, branchless banking agents, EMIs, PSOs/PSPs and other non-banking payment players. Participants may have the choice to send their transactions to the ATS or the MPG based on their needs.
- The MPG should allow for complete interoperability with/between existing Banks, PSOs/PSPs and all licensed wallets providers including EMIs and Branchless Banking providers. The MPG at a minimum should offer an interoperable QR Code scheme and a bill payment functionality.
- A National Payments Council with representation from users and providers of payment services, bank and non-bank industry participants and authorities would be useful in providing guidance as the payments infrastructure evolves.1Link must urgently adopt risk mitigation measures which eliminate interbank risks. They should conduct a self-assessment of their respective systems as soon as these measures are decided.

Cheques & Cheque Clearing

Cheque is the most used payment instrument in the traditional banking sector in Pakistan. They are extensively used for commercial payments.

Cheques are everywhere in Pakistan regardless of being one of the most inefficient payment instruments. In terms of processing, cheques are manually collected from over 280 locations in the country and transferred to the National Institutional Facilitation Technologies (NIFT) calculates a single multilateral net settlement position for each participant aggregating all its clearing positions across the 16 SBP locations. Usually there are three clearing cycles and three return cycles and for each of these cycles there is a separate multilateral net settlement in PRISM. There is a high human and time cost to such manual processing. Further, cheques drawn on a bank account located in another city can take up to four working days to be credited in the account of the beneficiary.

Moreover, no procedure is in place to discourage cheques to be written when no money is available on the drawer’s account. As a result, on average, 8% of the cheques are returned. In practice, cheques have become an instrument used by debtors to force creditors to grant commercial credit. And while cheques are costly to process, their use is very lightly charged to customers. If this situation is not changed, the development of more modern and more efficient payment instruments is likely to be very difficult.

An analysis should be made to identify the origin of high value cheques and to define a policy to forbid or to deter the issuance of cheques above a certain threshold, and to facilitate the processing of such payments in PRISM.

Securities Settlement

Government securities are settled at the Central Bank while corporate securities are cleared and settled by private organisations.

Private settlement occurs in an uncommon manner, with securities first being transferred before being cleared, and cash being distributed through different settlement agents. As a result, systemic risks embedded into the securities settlement arrangement is potentially huge because the failure of a settlement agent might trigger the failure of the settlement organization. Furthermore, customers often pay brokers through cheques that are credited on a next day basis but take two days to clear. This often creates a liquidity mismatches for the brokers.

Where it is feasible and practical the settlement organization should opt for settlement in Central Bank money. This requires access and participation criteria to permit other settlement organizations to be members/participants in the RTGS system.

Recommendations

- Self-assessment of PRISM and 1Link against the PFMIs. The self-assessment of PRISM should include the government securities settlement function embedded into the system
- Amendment of the procedures in the PRISM environment which expose it to credit exposures on participants. This concerns the absence of haircuts in the collateralization process and the absence of real-time booking of cash withdrawals
- Clarification of the criteria and procedures for becoming direct participant in PRISM
- Adoption by 1Link of risk mitigation measures
- Review of the interface between PRISM and the SBP core banking application
- Implementation of an ACH function through an ATS system, and of a Micro Payment Gateway for Branchless Banking transactions
- Analysis to identify the origin of high value cheques and to define a policy to forbid or to deter the issuance of cheques above a certain threshold, and to facilitate the processing of such payments in PRISM
- Cost study of payment instruments
- NCCPL and SBP should consider the opportunity to organize the settlement of the cash side of NCSS transactions in Central Bank money
- NCCPL should undertake a self-assessment of its functions as a CSD and SSS based on the PFMIs, with a separate self-assessment of its functions as a CCP
- Stress tests should be organized urgently to ensure that the CCP clearing can overcome the failure of, at least, the participant with the highest net debit position

RETAIL PAYMENTS MARKET

The retail payments market in Pakistan is in flux. The commercial banks, MFIs, postal office, non-bank payment service operators (PSOs), mobile network operators (MNOs), money transfer operators (MTOs), and quasi-government organizations are jockeying for position to lead the nation's transition from in-person, cash payments to agent-assisted and electronic payments. Some are more actively engaged than others.

The persistent use of cash in conjunction with electronic payment services is strongly evident for retail payment services used primarily by consumers and small business entities, as well as those used primarily by larger entities and the government. The latter includes cheques, interbank customer transfers via PRISM, and online banking. Former include agent-assisted payment services, card-based services, mobile- and internet-banking, call-center banking and agent locations.

Most of the industry driven dynamism is focused on two small and medium size payment use cases: bill payment and person-to-person (P2P) payments, however, other major payment use cases includes merchant payment acceptance, tax payments, international remittances, and agriculture produce payments that are currently predominantly paid in cash.

In two other use-cases, government-to-person (G2P) payments and private sector wage payments, measurable albeit much less dynamic progress is being made. Both are moving to electronic payment delivery channels. Other government payment use cases including person to government (P2G), government to business (G2B) and business to government (B2G) remain largely paper-based. Further, for private and public-sector wage payments and other types of G2P payments, payments are increasingly being delivered electronically but recipients make little or no use of the electronic payment options made available to them.

Apart from banks and MFBs, exchange companies, Pakistan Post, NADRA offer select payment services. EMIs currently being licensed are expected to play a major role because of their low dependence on banks.

Key Trends in Retail Payments Usage

Cash remains the payment instrument of choice in Pakistan, with a small number of non-bank electronic transactions the largest form of digital payments are cash withdrawals using ATMs. Limited use of electronic payments is made for payments to third parties. Cheques are the single most popular non-cash instrument for third party payments. Market segmentation exists based on large value retail payments (primarily those made by corporates) and smaller and medium payments (made by small businesses and consumers).

Larger Value Retail Payments Market

As mentioned, for business entities and the government, Cheques are second only to cash as the most popular payment instrument; the use of cheques by consumers is uncommon. Over 237 million cheques were used during FY 2019, 56 percent of which were used to withdraw cash. Another 21 percent of the checks were used to transfer funds amongst the account holders' own bank. The remaining 23 percent of the checks, 48 million, were used to pay funds to third parties.

Amongst electronic payment instruments the most popular instrument for larger value retail payments and receipts is RTOB. Since 2015, the volume and value transferred to RTOB has increased by 20% and 37% respectively, reaching 61.3 million in volume and Rs.36 trillion in value for funds transfers in FY19. Notably, like in the case of cheques, the majority of all RTOB transactions are cash or own-account management transactions. In volume terms, 67 percent of transactions in FY2019 were cash deposits and withdrawals. Another 33 percent were account to account transfers. In value terms, 73 percent of the transfers were account to account transfers.

The heavy use of checks and online banking instruments for cash transactions suggests that the electronic means available to business entities and government entities fail to meet their payment needs.

Small and Medium Value Retail Payments

The heavy reliance on cash is even more apparent in the market for small and medium size retail transactions.

There are a range of types of payment services available to those with small and medium size payment needs, including consumers and small businesses. These include payment cards, internet banking, mobile banking, agent-assisted banking, remittance and bill payment services. The volume and value of transactions via these services that are not cash withdrawals or transfers between personal accounts are very small.

The limited use of electronic instruments to conduct third party payments persists, despite significant progress in expanding access to those instruments. Two of the credit transfer instruments, internet-banking and mobile-banking, have enjoyed only modest growth. Registration for call-center banking, has enjoyed steady growth. Only Branchless Banking (i.e., mobile money) has seen significant growth.

Retail Payment Patterns by Instrument & Access Channel

The patterns of usage of across retail payment instruments differ significantly. The variations in the frequency and values reflect the differences in the ways customers use each access channel.

Card transactions via ATMs are predominantly used to withdraw cash. In value terms, they also play a role in facilitating the transfer of funds to third parties. Credit transfers are growing in popularity amongst bank account holders to conduct third party payments. Purchases of goods and services, utility bill payment, transfers of funds to third party accounts and the management of personal accounts can all be conducted electronically. Internet banking is used heavily for account-to-account fund transfers, and utility bill payments among others. Mobile banking also reveals heavy use of account-to-account transfers and, in volume terms, significant utility bill payment activity. Account holders make little use of mobile access to make payments for goods and services.

Retail Payments by Use Case

Retail payments differ depending on their specific use case. The strategy will cover those that represent the biggest opportunity for scaling the use of electronic payments.

Utility payments are one of these cases. They can be leveraged to provide end-users with their first introduction to electronic payments, primarily because of the necessity to pay utilities, usually on recurring basis. According to the 2017 Findex survey, 31 percent of adults in Pakistan make utility payments. Making utility payments in cash is inconvenient and time consuming. Currently, most payments are made through agents as over the counter transactions using Branchless Banking or through NADRA. Utility bill payments via other electronic channels are relatively small.

Apart from utility payments, third party 'Payments' for the purchase of goods or services are typically one-time transactions, made at the time and place of purchase, in person or online. It is typically quite convenient to use cash for in person payments and for online purchases when it is impossible to use cash. POS transactions and internet banking are essentially the only electronic means to conduct such retail payments. Branchless Banking account based payment services are not yet outfitted with the capacity to conduct payments.

Payment Cards

Payment card penetration has reached a significant level, buoyed in part by the increasing use of cards for wage payments and G2P payments. This is an important prerequisite to stimulating greater card acceptance by merchants and, therefore, the use of cards for purposes other than cash withdrawal.

Use of Cards

Cards are the most popular instrument, as measured by the total number of transactions, for retail transactions by consumers and small businesses. Cardholders almost exclusively use their cards only to withdraw cash.

Card Access Channels

One of the factors limiting the use of cards to conduct third party payments is the very limited availability of places and means to conduct cards payments. In terms of physical access points, as of 2019, there 14,722 ATMs in Pakistan, that is only 11 ATMs for every 100,000 adult residents. In that regard, Pakistan compares poorly with other countries. Additionally, there are issues with frequent cash outages, network and power availability, the cost of alternative energy sources, and problems in cash supply chain management. However, over the past 2 years, the performance and availability of ATM services has greatly increased and the downtime has drastically decreased due to mutual efforts by SBP and the industry.

The availability of POS acceptance devices has grown more briskly than that of ATMs. By FY2019, there were 56,911 POS acceptance devices in use, 48 for every 100,000 adults. Multiple terminals per merchant significantly reduces this figure.

Agent Assisted Small Value Retail Payments

Given the relatively low rates of account ownership amongst adults in Pakistan, agent-assisted retail payments play a very important role in the transactional life of everyday Pakistanis. The two prominent providers of such agent-assisted transactions services are NADRA and the banks via their Branchless Banking services offerings.

NADRA plays a major role in the bill payment market, capturing around 25 percent of the bill payment market in volume terms. According to NADRA, it was the first mover in this segment of the retail payments market. NADRA operates its cash bill payment service through a network of 10,000 franchised agents. Customers use cash to initiate their payments at the NADRA agent locations and receive an electronic receipt, either on their phone or from the agent.

Branchless Banking is the most dynamic sector in the retail payments market. However, over 70 percent of Branchless Banking transactions are over-the-counter (OTC) transactions. OTC transactions are conducted by an agent for clients that do not have a Branchless Banking account, or if they do, choose not to use their account. Branchless Banking service providers report that the bulk of the OTC transactions are bill payments and domestic remittance transfers.

Recommendations

- Open the retail payments market to non-banks. Establish a legal and regulatory framework for non-banks
- Forbid (and enforce the prohibition of) the use of exclusivity agreements between major card companies and PSPs, PSPs and super-agents, and between super-agents and agents, etc.
- Consider the role of the legal and regulatory framework in establishing a level playing field for bank and non-bank PSPs
- Clarify the distinction between basic bank accounts and Branchless Banking accounts
- Offer incentives for merchants and other providers of goods and services to accept electronic payments, including via cards, mobile banking, and Branchless Banking payments
- Launch incentive programs to stimulate the use of electronic payments, and the acceptance of electronic payments
- Consider tax incentives for the acceptance of electronic payments
- Foster / ensure interoperability between Branchless Banking payments and all other types of retail payment services
- Consider means to strengthen collaboration between financial and non-financial government authorities to boost Branchless Banking and digital financial inclusion efforts
- Open the market to more competition, by allowing non-banks to offer bill payment services.
- Level the playing field by requiring quasi-governmental entities, such as NADRA, to abide by the rules and regulations in place for all non-bank payment service providers
- Consider the impact and structure of fees imposed by NADRA for identify verification, especially per transaction fees
- Forbid (and enforce prohibition of) the use of exclusivity agreements between bill payees (especially, utilities) and bill payment service providers
- Encourage broader adoption of electronic wage payments
- Enhance the ability of employers to allow employees to receive their wages in the bank or Branchless Banking account of their choosing by implementing a robust ACH solution
- Consider requiring the provision of certain features, such as low-cost transactions and free account balance inquiries, with electronic wage payment accounts
- Consider requiring that such accounts offer access via a variety of instruments, including mobile banking and internet banking
- Consider requiring banks and PSPs to provide on-site employee training, ATM and internet bill payment services for large employers that use their salary payment services

OVERSIGHT AND COOPERATION

Definition of Oversight

The Central Bank's role as an overseer is to ensure the safe, reliable and efficient functioning of payment and settlement systems. Therefore, one of the overarching objectives of oversight over retail payment systems and retail payment instruments is to foster public confidence in the currency and in promoting a less-cash economy. Safe and efficient retail payment instruments facilitate various types of retail payments such as P2P; P2B; B2P; P2G; G2P; B2G; and G2B payments. Using retail electronic payment instruments for all these types of payments for instance results in significant cost savings to the economy and contributes to economic growth.

Legal Basis of Oversight

The legal basis for oversight in Pakistan can be derived in broad terms from the State Bank of Pakistan Act, 1956, and more specifically from the Payment Systems and Electronic Fund Transfers Act, 2007 (PSEFT Act). The Act states that the SBP while exercising its powers, it should do so: (i) to contain systemic risk; (ii) to promote monetary stability and a sound financial structure; (iii) protect public interest including market conditions and behavior; (iv) ensure the safety, integrity, efficiency or reliability of the Designated Payment System or Designated Payment Instrument including security and operating standards and infrastructure arrangements; and (v) take into account the interests of the current and prospective participants and users of the Designated Payment System and Designated Payment Instruments respectively.

The PSEFT Act enables the SBP to classify payment systems as "Designated payment systems (DPSs)". Only DPSs are covered by the provisions of the Act. It also empowers SBP to classify payment instruments as "Designated Payment Instrument (DPI)", providing oversight responsibility as well. As of now, few organizations are designated as DPSs and no organization has been classified as a DPI.

Current Oversight Framework & Activities

There is a dedicated oversight division within the Payment Systems Department. The oversight division has 4 sections – (i) systemically important payment systems; (ii) retail payment systems; (iii) data compilation; and (iv) fraud monitoring.

The SBP issues rules, guidelines, circulars, bye-laws, standards or directions as considers appropriate to regulate the conduct of all or any of the Service Providers, Operators of Payment Systems or issuers of Payment Instruments in Pakistan. The SBP has over the years in exercise of its powers issued several circulars, circular letters and guidelines pertaining to payment and settlement systems –operators and service providers, payment instruments in Pakistan.

PSD has prepared an oversight policy framework document that has been approved by SBP. A framework on designation criteria for classifying payment systems as DPSs in terms of the PSEFT Act has been issued by SBP. As per the framework, DPSs will include payment systems operated by both the SBP and private entities. PSD also collects and publishes data relating to the size of payment instruments like ATMs and POS and value and volume of transactions, cash withdrawals; payment transfers; bill payments); cheque transactions; online banking transactions (internet, mobile, and call center/IVR); and e-commerce transactions (card-not-present transactions).

Collateral Risk Management Issues

It is observed, that the SBP provides intraday credit to participants on a fully collateralized basis in PRISM. Government securities are accepted as eligible collateral, based on their low credit, liquidity and market risks.

The SBP should accordingly implement collateral risk management measures. The SBP should establish prudent valuation practices and develop haircuts that are regularly tested and consider stressed market conditions. This is necessary to be certain that in the event of liquidation of the collateral, the SBP is assured of its full value. SBP should establish stable and conservative haircuts that are calibrated to include periods of stressed market conditions, to the extent practicable and prudent.

SBP should avoid concentrated holdings of certain assets where this would significantly impair the ability to liquidate such assets quickly without significant adverse price effects. This is accomplished by establishing concentration limits or imposing concentration charges

SBP should also consider implementing a well-designed and operationally flexible collateral management system and allocate sufficient resources including staff to its collateral management system to ensure an appropriate level of operational performance, efficiency, and effectiveness.

Recommendations

- Establish prudent valuation practices and develop haircuts that are regularly tested and consider stressed market conditions to reduce the need for procyclicality
- Impose concentration limits
- Use a well-designed and operationally flexible collateral management system
- There is a need to further enhance the efforts underway to help the SBP establish a strategic and comprehensive oversight policy framework
- The draft Designation framework (which is work in progress) should be reviewed with the provisions of the PSEFT Act. The draft criteria for designation does not seem to fully capture important elements
- The SBP should classify existing payment instruments in use in Pakistan as DPIs. Cheques should also be classified as DPIs as well
- The draft oversight policy framework could be enhanced to include securities settlement, retail payment instruments
- More focus should be given to developing a cooperative framework for guiding the national payment system development in Pakistan
- An inter-departmental coordination committee should be established to foster inter-department coordination. The PSD should be involved in the process of licensing, data collection and off-site and onsite supervision and inspection activities under the Branchless Banking umbrella
- The existing MoU between the SBP and the Securities regulator should be reviewed and enhanced to capture all aspects as outlined in Responsibility of the PFMIs
- Set up a permanent consultative body comprising all stakeholders (regulators, market infrastructures, non-bank payment service providers and participants) to prepare and drive the country's payment and settlement systems strategic development in Pakistan, tasked with preparing a strategic and holistic action plan with defined timelines for the modernization and development of payment and settlement systems in line with international standards
- Periodical analytical reports should be generated by the data collection unit to aid in policy making

PAKISTAN GOVERNMENT PAYMENTS

The government is the single largest end user of payment services. Governments collect and disburse payments to individuals and businesses for a variety of different purposes, Government payments also vary in size and reach with the level of government and the agency conducting the payments.

The two largest categories of spending were 'debt servicing' (interest and principle repayment) and 'operational expenses'. The third largest was 'government transfers'. A very small share of total transfer payments is referred to as 'other transfers', and is believed to include social benefit payments.

The Government of Pakistan continues to pursue its own efforts to transition to electronic payments. The results of these efforts are so far mixed. Most employee salaries, as well as selected social benefit and pension payments, receive their payments via 'direct' deposit. However, even in these cases, the underlying process through which the government conducts those payments is not fully automated.

Progress on the revenue collection side lags significantly behind that on the disbursement side. Most payments to the government are made in person via cash or cheque.

The degree to which government payments are being leveraged successfully to foster the use of electronic payments and transaction accounts, and thus, financial inclusion, is limited. Payment account design, the accessibility and convenience of points of access and the degree of customer awareness and confidence remain issues.

Payment Disbursement Processes & Mechanisms

Government Salary & Pension Payments

Federal government salary payments were among the first government payments to be transitioned to electronic processing and delivery. Across the country, there are 2.5 million government employees and over 1 million government pensioners. For federal employees, virtually all have transitioned to 'direct deposit' to the bank accounts of the recipients. It takes four to five days to process employee salary payments.

For government pensions, the process differs from that for government salary payments. AGPR works through SBP and Pakistan Post to deliver the payments to some 1.5 to 1.6 million government pensioners. However, exempted government agencies and quasi-government entities pay their pensioners directly.

Social Benefit Payment Programs

The two largest social benefit programs for civilians are the Benazir Income Support Program (BISP) and the Employee' Old-Age Benefit Institution (EOBI). There are 5.2 million BISP recipients, 384 thousand EOBI recipients, and an estimated 4.5 million active EOBI pension system contributors.

BISP Payment Mechanism

The administrators of the BISP have experimented with a variety of electronic benefit payment mechanisms – smart cards, mobile phones and, most recently, debit cards. 94 percent of the 5.3 million BISP recipients, all of whom are women, receive their quarterly benefit payments via the Benazir Debit Card (BDC). This has faced several challenges. These challenges included payment authentication, ATM access and reliability, the timeliness of payments, the absence of consistency in the underlying accounts provided by the banks, and the inability or unwillingness of banks to provide customer support for the use of the BDCs by BISP beneficiaries.

Key challenges with authentication and ATM access remain. The authentication challenges stem from the use of a pin code as the single factor verification for payments. The BDC cards are not embossed with the beneficiary's name or any other verification information. From the onset of the BDC, beneficiaries have had trouble recalling their pin numbers. Some banks report their call centers receive up to a million calls every quarter from BISP beneficiaries, most of which are pin number requests. ATM access challenges stem from the limited absolute number of ATMs available across the country and, according to observers, the failure of banks to replenish their ATMs and ensure the ATMs are functioning.

The constraints associated with the use of the BDC cards and the nature of the underlying bank accounts raise broader issues associated with the BISP approach to electronic payments. By program design, BISP recipients are not allowed to add value to their BDC cards, and therefore, to the underlying bank accounts. Furthermore, funds left on the cards for more than 180 days are subject to being returned to BISP.

Two-thirds of the BISP related transactions were conducted over a three-day period were conducted by men. While this compares favorably to the share of non-BISP related transaction conducted by men, at nearly 97 percent, it calls into question the effectiveness of the exclusive targeting of BISP to women.

An entirely new system is being developed for beneficiaries and will be rolled out shortly. They will be able to draw their funds at agent locations or via POS devices using their CNIC and their thumbprint. This enhances the transparency of payments, reduce thief from recipients, and ensures that the BISP recipients themselves, withdraw their benefit payment, rather than having a representative.

EOBI Payment Mechanism

The EOBI is a mandatory pension system to provide pension coverage for private sector employees. It is the third largest pension program in the country, in terms of number of recipients. It is mandatory to cover all companies with five or more employees. Historically, most EOBI pensioners (or their survivors) received their payments in cash at a branch of NBP. EOBI has now shifted almost all EOBI pensioners to a new electronic payment disbursement system with Bank Alfalah.

Bank Alfalah started the process of registering EOBI pensioners in May 2016, and by the end of November 2018, 405,000 EOBI pensioners had been transitioned to the new payment mechanism.

Government to Business Payments

G2B payments account for a significant share of consolidated government spending. An estimated 30 percent of government spending, approximately the same share as salary and benefit payments. A small number of the G2B payments are associated with large government payment programs. Most are one-time payments, in the sense that each payment is made and authorized separately. The Government of Pakistan lacks the means to conduct end-to-end G2B payments electronically.

Tax and Non-Tax Revenue Collection Processes and Mechanisms

Tax Payment Processes and Mechanisms

Two types of taxes -- sales and income taxes -- account for the bulk of the revenue collected by the Pakistani government, 70 percent of the total. The sales tax, which is a value-added tax (VAT), is the top revenue generator. The income tax, also known as the direct tax, generates nearly as much in tax revenue as the sales tax. Notably, at this point, virtually all individual income tax payers are employees of firms with five or more employees, whose employers withhold and submit their (the employees') tax payments on their behalf.

The FBR is responsible for the collection, processing and recording of virtually all tax revenue collected in the country. The other is the NBP, which together with the SBP, are the only entities in Pakistan that can collect tax payments from the public on the behalf of the federal government.

PRAL has aggressively pursued the modernization of tax collection starting with the automation of tax processing and, most recently, the establishment of an efficient and user-friendly means for individuals and entities to file their taxes electronically. Last year SBP worked with FBR, Pakistan Customs and GoP to leverage on the interface developed by PRAL. Taxpayers can electronically generate PSID of the goods declaration through the WeBOC system of Pakistan Customs.

Non-Tax Revenue Payments to the Government– B2G & P2G

However, other non-tax collections for both federal and provincial governments of non-tax revenue (including fees and fines) is the most decentralized and varied of all the revenue collection processes. Each government agency or entity is on its own when devising means to transition from cash to electronic collection of the payment of fines and fees, and manual to electronic recording and reconciliation of the payments.

Cross-Cutting Observation & Recommendations

Government transition to and use of electronic means to disburse and collect funds serves a variety of purposes. However, the use of electronic payments by the government is a necessary but not a sufficient condition to achieve these positive outcomes. The achievement of the efficiency, cost and transparency gains to the government depends, in part, on the degree of cooperation and coordination of approaches across government agencies and levels of government, and the degree to which government payment processing is fully automated and integrated with the national payment system. Factors outside the control of the government payment management authorities also can constrain or support the achievement of the potential gains to the government.

The Government of Pakistan has made significant progress in transition to electronic payments, however, several additional measures could be taken to enhance the benefits of the transition.

Recommendations

- Foster adoption of electronic payments by all government entities: Encourage and support an acceleration of transition to electronic payments by all government entities at all levels of government
- Provide/offer technical assistance to government entities: Support the transition to electronic payments throughout the government, including exempted government agencies and other levels of government, by providing technical assistance.
- Address infrastructure weakness: Fill the gap in the nation's payment infrastructure by adding ACH functionality
- Consider the potential role of shared government payment platform(s): Explore the possibility of developing a shared government payment platform(s) to achieve efficiency across all government agencies and levels of government, and provide a range of options with regards to means of payment collection and distribution
- Enhance quality and reach of payment points of access: Explore options to expand the availability and enhance the reliability of payment access points to facilitate the use of transaction accounts made available to G2P recipients and electronic P2G and B2G payments
- Focus on payment product design: Prioritize payment product design when developing mechanisms to deliver or collect payments from individuals and business entities
- Offer payment options: Strive to offer individuals and business entities flexibility and choice with regards to the transaction account and payment instrument they will use to receive payments from and/or make payments to the government
- Avoid use of single purpose accounts and instruments: When necessary offer a payment instrument coupled with a government payment program, avoid single purpose instruments and those that offer only limited interoperability with other retail payment instruments and services

Detailed Recommendations by Payment Program Type

Government Salary Payments

The key strength of government salary payment programs is success of the AGPR in transitioning the employees whose salaries they pay via electronic payments; the weaknesses include the relative lack of progress in transitioning most of the government employees, all of whom are paid via other government salary payment programs. Specific comments and recommendation are as follows:

- Consider allowing government / SBP employees to deposit their salaries directly into Branchless Banking accounts

- The SBP should address the absence of automated clearinghouse (ACH) functionality in the financial system as soon as possible
- The AGPR may want to consider allowing employees to deposit their salaries directly into a Branchless Banking account
- Other exempted federal government agencies and provincial / district / local governments could be strongly encouraged to transition to electronic salary payments
- Collaboration across the government on transition to electronic salary payments could both encourage and support the transition of a broader range of government salary payment
- Greater emphasis on the accessibility of access points, their convenience and reliability will be important to efforts to foster the use of the transaction accounts to which salaries are deposited

Government Employee Pension Payments

The transition of government pension payments to electronic channels lags well behind that of salary payments. AGPR continues to pay pension payments in cash and require that pensioners use NBP as their pension disbursement agent. Government pensions paid by other government entities, such as the military, and by other levels of government, such as the provincial governments, are no further along in pension payments to electronic channels then they are in transitioning salary payments. Specific comments and recommendation are as follows:

- Collaborate within the government to identify critical payment instruments and account features for government pensioners
- Develop and provide guidance on protecting pensioners from financial fraud and abuse associated with their pension payments, including payment stream lending

Social Benefit Payments

Both BISP and EOBI, are now in the process of transitioning to a new electronic payment program. However, neither program appears to include design elements to leverage the payment programs to foster financial inclusion and, in specific, enhance access and use of transaction accounts.

Together, these two programs – the BISP and EOBI -- account for G2P payments to more recipients than all the other G2P programs combined. In addition, these social benefit programs reach some of the poorest residents of Pakistan. As such, they can play an important role in advancing inclusion in the country. In this regard, it is notable that transaction account ownership and use is considered a critical step toward broader financial inclusion. Specific comments and recommendation are as follows:

- Consider means to mitigate the impact of biometric payment cards and the related need to upgrade ATMs and POS devices with fingerprint readers, and provide convenient locations where BISP recipients can conduct electronic payments with their BISP cards
- Consider means to strengthen the impact of electronic social benefit payments on financial inclusion, by focusing on the design features of the transaction accounts and payment instruments made available to the recipients via the payment program
- Consider allowing recipients to choose from amongst the PSPs, the type of transaction account they would like to use to receive their payment
- Collaboration across government agencies and PPMs could reduce the cost and enhance the quality of each social benefit payment program

Government to Business Payments

Paper instruments, cash and cheques, remain the primary means of payment by the government to business entities. The absence of ACH functionality in Pakistan is believed to be the primary hurdle to shifting these payments to electronic instruments, including direct deposit. Specific comments and recommendation are as follows:

- Once ACH functionality is available, support efforts of government agencies and levels of government to shift payments to business entities to electronic channels
- Encourage government agencies/levels of government to adopt electronic G2B payment processing systems that enable business entities to choose the transaction account to which they want their funds deposited

Government Tax Revenue Collection

Private business entities are responsible for paying the vast majority of tax payments to the government. The process for filing tax returns has been automated and appears to be working relatively well. The process for making tax payments is neither automated nor electronic. Further, as mentioned earlier in 2018, SBP worked with FBR, Pakistan Customs and GoP to leverage on the interface developed by PRAL.

The FBR is urged to give high priority to shifting the collection of tax payments to electronic channels and enable tax payers to use transaction accounts provided by any regulated PSP to pay their taxes. Specific comment and recommendation is as follows:

- Shift the collection of tax payments to electronic channels and enable tax payers to use any transaction account provided by any regulated PSP to pay their taxes.

Government Non-Tax Revenue Collection

Non-tax revenues are collected by a wide variety of government entities. Many of these entities are likely to lack the technical knowledge, staff resources, and payment policy expertise to develop or select payment collection mechanisms that are efficient, meet their needs and meet the needs of those making the payments. Specific comment and recommendation is as follows:

- Explore means to provide technical assistance to government entities that collect non-tax payments from the public and business entities
- Foster collaboration across the relevant government entities to facilitate the efforts of each to develop appropriate payment collection mechanisms
- Consider offering workshops to government entities as an efficient means to share knowledge and exchange lessons learned

REMITTANCES

Overview of the Remittance Market

Pakistan is among the top ten recipients of international remittance flows. Only five countries in the world received more cross-border remittance flows than Pakistan. Remittance inflows to Pakistan were equivalent to 6.46 percent of its GDP. But Pakistan has not always been a major recipient of remittances. The rapid pace of growth of remittances to Pakistan can be attributed to a variety of factors. These include an increase in labor emigration, enhanced data collection, a reduction in the cost of sending remittances to Pakistan and a shift in remittance flows to authorized channels. Some of the growth in remittances can be attributable to the government's proactive remittance policy stance.

The core component of this policy is Pakistan's unique Pakistan Remittance Initiative (PRI). The PRI offers a fee rebate to bank and micro finance bank (MFB) remittance service providers (RSPs) that charge senders a zero fee to send remittances to Pakistan. It also provides support for bank and MFB RSPs in establishing tie-ins with RSPs in remittance source countries. The PRI was instrumental in driving down the cost of sending remittances to Pakistan.

Remittance Services

Cross-border remittances to Pakistan are sent and received via a variety of authorized and unauthorized channels. According to the SBP, an estimated 50 to 60 percent of inflows are transmitted to Pakistan via authorized channels. The other 40 to 50 percent are transmitted via family and friends (in cash and payments-in-kind), third party barter arrangements, and unauthorized remittance service providers (a.k.a., hundi).

Apart from the Pakistan Post, the only institutions in Pakistan that are authorized to provide home remittance services are the banks, MFBs and exchange companies. Migrants and their families have several options to choose from in terms of how and when remittances are delivered (or made available for pick-up) and, closely related to those options, where the funds can be accessed or used.

The average cost of sending remittances to Pakistan is relatively low compared to other developing countries around the world. However, the cost of sending remittances from Pakistan to other countries is well above the global average.

The cost of sending remittance to Pakistan has not always been so much lower than the global and lower-middle income countries averages. The Government's PRI program contributed significantly to the drop in the cost of inward remittances, as well as the low remittance cost structure in several of the countries that host Pakistani migrants.

Advancing Implementation of the Remittance General Principles

Transparency and Consumer Protection

Transparency requirements and consumer protections for remittance services derive from the PSEFT Act and its implementing circulars, which includes provisions on the protection of consumers, requirements for transparency of fees and statements, as well as clear complaint and redress procedures to protect consumers. No details are specified on the information that must be disclosed to remittance clients nor how that information must be presented.

As well, the act addresses electronic payments that are associated with an account, not cash over the counter transactions. This could create some legal uncertainly. Luckily, consumer protection for home remittance clients is strongly supported through action by the SBP. The PRI remittance call center and strict requirements regarding the speed with which remittance funds must be made available to recipients support this. The call center is in operation from 8:30 am to 7:00 pm. In a typical month, the call center handles 1600 - 1700 calls, approximately 100 of which are inquires and the 1600 complaints. Some of the recommendations are as follows:

- Consider issuing specific guidance on the information that must be provided to all remittance customers, including issuing a disclosure factsheet template

Payment Systems Infrastructure

Banks participating in the PRI were urged to use of the domestic payment infrastructure to enable the speedy delivery of remittances into the bank accounts of recipients, no matter where the recipients banked. Currently settlement uses a standard format free of charge, for individual interbank transfers of home remittances with no limit on the minimum value of a transaction. The decision was made to foster the use of straight through processing (STP) and real-time delivery of home remittances – without the risks introduced in the IBFT system. It was also introduced to discourage the issuance of demand drafts/payment orders by banks that are not participating in the PRI. SBP also introduced the use of IBAN account numbers to facilitate STP of home remittances to recipients' accounts. Some of the recommendations are as follows:

- Consider using the Prism system to process interbank direct deposit of home remittances as an interim solution to avoid the risks associated with the IBFT solution

- Consider establishing an ACH system and transitioning interbank direct deposit of home remittances to the ACH system
- Consider using IBAN numbers for Branchless Banking accounts to enable direct deposit of home remittances to Branchless Banking accounts
- Continue to pursue the push for banks, and other PSPs, to adopt STP of home remittance transactions

Legal & Regulatory Environment

The Foreign Exchange Manual, specifically addresses home and outward remittances. While the restrictions on home remittances are relatively relaxed, the restrictions on outward remittances are quite tight. The restrictions may be forcing residents that would like to send small sums of funds abroad to their families to use unauthorized channels. Evidence of the impact of the restrictions is clear in sharp difference between the cost of inward and outward remittances.

In general, banks are required to ensure adequate controls in the process of the transfer and payment of remittances in a beneficiary's account and for cash over-the-counter (CTC) transactions. Participating banks are also reminded that they are required to carry out procedures to ensure strict compliance with all the SBP rules and regulations, including those related to KYC and AML/CFT measures. As well, regulation sets explicit deadlines for the completion of home remittance transactions by banks, with deadlines varying in accordance with the means of delivery. Penalties are defined as well. Some of the recommendations are as follows:

- Consider means to ensure all authorized RSPs are treated equitably under the respective payment and foreign exchange regulatory and oversight frameworks
- Reconsider the legal and regulatory restrictions on outward remittances

Market Structure & Competition

The authorized providers of cross-border remittance services include banks, MFBs, exchange companies, and the postal service. These RSPs conduct cross-border remittances via arrangements with banks, MTOs, exchange companies, and postal offices in the remittance source countries. Foreign MTOs and exchange companies are not allowed to directly serve their remittance customers unless they have specific permission. Most remittance flows to Pakistan are sent via MTOs or exchange companies.

According to the PRI, there are now 26 banks and five MFBs active in the home remittance market in Pakistan. Competition is encouraged. The catch in the broader home remittance policy in Pakistan lies in what appears to be inequitable treatment of authorized RSPs. Banks and MFBs appear to receive greater support for their provision of home remittance services than Exchange Companies. Banks and MFBs also appear to be subject to greater scrutiny than Exchange Companies. Banks and MFBs appear to be provided with greater assistance in arranging tie-ups with foreign RSPs, enjoy direct access to the IBFT and PRISM systems, and can take advantage of the PRI remittance fee rebate. On the flip side, Exchange Companies appear to be able to ignore the prohibition of exclusivity agreements, consumer recourse requirements, and lack sufficient disclosure on their websites relating their foreign RSP partners.

The apparent bias against the Exchange Companies, combined with limited investment by banks in expanding their access networks, may be constraining the ability of the PRI to attract more remittances to authorized remittance channels. Authorized remittance services continue to compete with unauthorized means to conduct remittance transactions. The convenience and accessibility of authorized remittance services, including for the collection of remittance funds, appears to continue to be a significant barrier to usage. Some of the comments and recommendations are as follows:

- Consider expanding the scope of the PRI program to allow Exchange Companies to participate in the program

Governance & Risk Management

No information is currently available on governance and risk management practices of cross-border RSPs in Pakistan. Some of the comments and recommendations are as follows:

- Issue corporate governance and risk management requirements for RSPs, including Exchange Companies and banks, with respect to their inward remittance business
- Require RSPs to develop and exercise robust agent management and risk mitigation practices

Advancing Implementation of the PAFI Guiding Principles

Large volume payment streams or programs that reach many people (or micro, small and medium size businesses) can be leveraged to advance financial inclusion.

The Government of Pakistan and the SBP are clearly committed to fostering the development of low cost, account based home remittance services. The commitment of the SBP has been sustained over the past decade and is evidenced by the on-going efforts of the SBP to establish safe and efficient means to enable interbank transfers of home remittances.

However, the commitment and vision of the private sector with respect to advancing access and use of transaction accounts to conduct home remittances can be called into question. The most obvious and long-standing weakness is the failure of the private sector to significantly expand the reach, reliability and convenience of access points. Other signs of half-hearted commitment include the failure of banks to adopt STP and slow pace of transition to the use of IBAN account numbers.

Perhaps the areas of greatest weakness in Pakistan's remittance market is product design and readily available points of access / electronic payment acceptance, arguably among the most difficult to achieve. The government does not have a direct role either remittance product design or the reach of access networks. Some of the comments and recommendations are as follows:

- Consider means to stimulate stronger private sector commitment to meet the payment needs of remittance recipients via electronic payment services and attractive transaction accounts
- Deepen the emphasis of risk management in the provision of remittance services
- Explore means to more effectively enforce the ban on the use of exclusivity agreements and level the playing field for RSPs
- Consider adopting a broad view of retail infrastructure needs to facilitate the leveraging remittances to advance financial inclusion
- Encourage the launch of multipurpose accounts & flexible payment instruments for home remittances that can be used to meet other payment needs
- Reconsider policies and incentives to expand access networks and interoperability to foster the use of remittance direct deposits