

2 Payment System

The role of Payment Systems, which establishes common standards and procedures, has been considered vital as it promotes competition in the provision of payment services and enhances efficiency by enabling interoperability. Interoperability would improve user convenience through sharing of different alternate delivery channels like ATMs, POS terminals, agents, etc., and promoting competition among digital financial service providers.

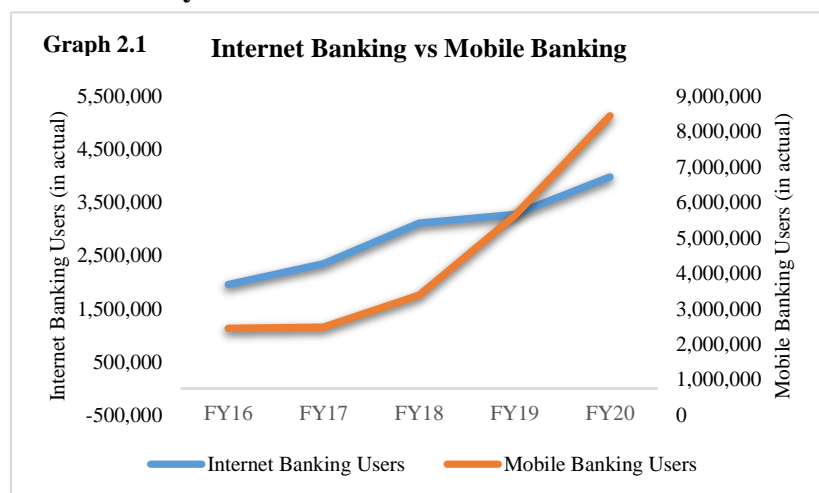
In the wake of COVID-19 global pandemic which has posed serious economic and social challenges for regulators, policy makers and services providers, etc., the digital transformation has become vital, not only for payments and financial services but also for every sector of the economy catering to financial needs of the customers. SBP, being the regulator of payments and financial industry, has played a great role to promote and develop payment and digital financial services in the country. As regulator of payment systems, SBP took numerous steps, which, inter alia, include promoting and developing interoperable payments infrastructure, issuing enabling regulations especially for retail payment providers and FinTechs, ensuring the trust and security of digital payment channels, promoting new technologies and innovations etc.

These initiatives are primarily aimed at development of digital payment platforms, provision of a conducive regulatory environment for the industry and promotion of innovative and convenient digital payment instruments in the economy. As a result, the payments industry in Pakistan continued to show a healthy growth, both in terms of volume and value of transactions conducted during FY20. A detailed analysis of the key digital payments indicators and initiatives of SBP to promote payment systems and digital financial services in the country is given in the following sections.

2.1 Trends in Payment and Settlement Systems

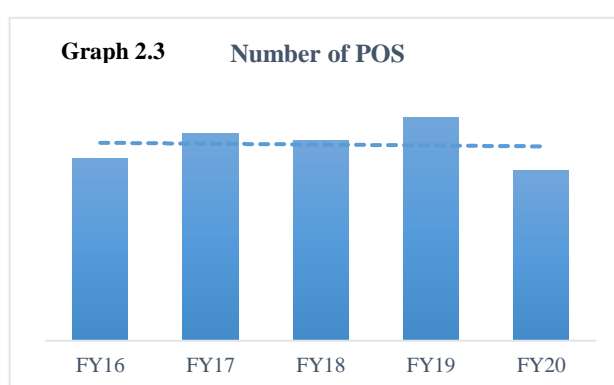
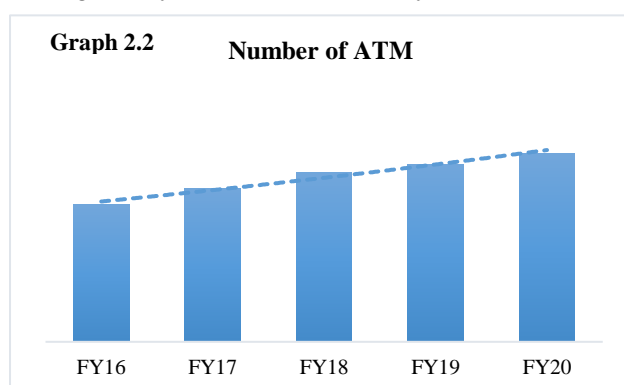
In recent years, banking through digital channels has been gaining popularity in the country and number of transactions through digital means has seen considerable growth in FY20. These channels offer alternatives resulting in faster delivery of financial services to a wide range of customers. As evident from the fact that in the last 5 years, significant

progress has been observed in the usage of Internet Banking and Mobile Banking channels showing annualized transactions growth of 31 percent and 88 percent respectively. It is further corroborated from the fact that substantial growth has been observed in the user base of these channels, during the same period, as is evident from the Graph 2.1.

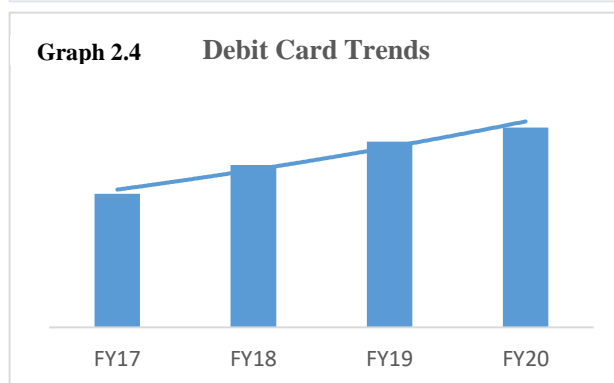


Further, growth was observed in the number of Inter-Bank Fund Transfer (IBFT) transactions too, especially after the start of lockdown period imposed due to COVID-19 pandemic, wherein SBP after consultation with market participants, waived all charges on fund transfer transactions conducted through online channels. Before the regulatory intervention, the number of interbank fund transfers were recorded at a daily average of approximately 188000, whereas, after the intervention, the number rose to more than double on a daily average basis.

In addition, the adequate increase has been witnessed in digital access points and infrastructure whereby number of ATMs showed continuous growth, with YOY growth of 6 percent. The number of POS machines, which have remained stagnant during the last few years, is expected to improve due to the regulatory intervention made by SBP.



Number of debit cards increased substantially, mainly due to the mandate given by SBP for issuing Europay Master Visa (EMV) Chip and PIN Compliant cards, thus adding more security without compromising customer experience. The number of debit cards at the end of FY20 have been 26.7 million, observing a YOY growth of 7.5 percent.



The usage of digital channels has seen growth compared to last year, which is summarized as under:

Channel	Volume (in million)	FY19		FY20		Percentage Change	
		Value (in PKR billion)	Volume (in million)	Value (in PKR billion)	Volume	Value	
RTOB	187.4	49,430.7	173.7	54,433.2	(7.3)	10.1	
ATM	523.3	6,399.6	512.1	6,429.4	(2.1)	0.5	
POS	72.4	366.2	70.3	364.2	(2.9)	(0.5)	
E-commerce	5.7	26.1	10.2	34.9	78.9	33.7	
Internet Banking	39.7	1,722.2	56.6	2,952.7	42.6	71.4	
Mobile Banking	41.1	866.8	82.8	1,763.6	101.5	103.5	

2.2 Performance of Payment Systems During FY20

SBP took significant steps that are expected to provide strategic direction and roadmap to build a more modern and robust payment systems in Pakistan, as envisaged in SBP's Vision 2020. Some of the major steps taken during FY20 are as follows:

2.2.1 Launch of National Payment Systems Strategy (NPSS)

SBP, in its Vision 2020, aimed to develop modern and robust payment systems by developing National Payment Systems blueprint in the country. The objective was to provide recommendations to design a comprehensive national payment architecture in line with international standards. In this regard, SBP through World Bank's Financial Inclusion Support Framework (FISF) program, drafted a comprehensive National Payment Systems Strategy after consultation with all relevant stakeholders including Government agencies, Banking and Financial Industry leaders, Technology Service providers, FinTechs, etc.

Governor SBP, Dr. Reza Baqir in a ceremony attended by World Bank President Mr. David Malpass, launched NPSS on November 01, 2019. The strategy outlines various recommendations in six major areas of national payment systems i.e. legal and regulatory framework, payment infrastructure, retail market, government payments, oversight of payment systems and remittance market.

Since the launch of the NPSS, SBP has been leading industry engagement through various consultations and sessions to drive the digitization objectives as laid down in the strategy. In this regard, SBP has already taken several initiatives in line with NPSS to improve payment infrastructure, increase digital payments acceptance points, facilitate digitization of government payments and promote non-banking payment entities and FinTechs by providing an enabling and level playing field.

2.2.2 Implementation of the Micro Payment Gateway (an Instant Payment Scheme)

Micro Payment Gateway (MPG) – an instant payment scheme - is an initiative taken by SBP to achieve its strategic goal of developing modern and robust payment systems in the country. MPG is a state-of-the-art, interoperable and secure payment platform that would enable consumers, merchants and government entities to exchange funds in a seamless, instant and cost effective manner. It has advanced functionalities to process instant/near real-time and alias based payments, bulk transfers and Request-to-Pay and capability to on-board participants including banks, merchants, Electronic Money Institutions (EMIs) etc. through Application Programming Interfaces (APIs).

SBP, in collaboration with international partners, experts, vendors and financial industry, has achieved various milestones. It has accomplished the major milestone of the project by ensuring deployment of the state-of-the-art infrastructure to build and operate the gateway. SBP is now in the final stages of going live with first use case i.e. bulk transfers including government to person (G2P) transfers, tentatively by the end 2020.

2.3 Regulatory Measures Taken by SBP during FY20

Key achievements to strengthen and promote Payment Systems regulatory regime are listed below:

2.3.1 Improving Payments Card Acceptance in Pakistan

The payment acceptance infrastructure in Pakistan has not gained traction and number of access points particularly POS terminals remained stagnant for the last many years. SBP, after analyzing the payment cards market, found that this distortion is mainly due to asymmetry in the market, whereby issuers (institutions issuing payment cards to their customers) were the most profitable, leaving less margins for acquirers (institutions in the business of deploying POS machines) as they were operating at a loss.

In order to address the challenges in POS acquiring business such as undercutting, rationalizing card issuers' share and increasing POS card acceptance infrastructure in the country, SBP intervened through policy interventions, which include:

- Mandating floor on the Merchant Discount Rate (MDR) for POS acquiring
- Capping Interchange Reimbursement Fee (IRF) for debit and prepaid cards
- Mandating banks/card issuers to offer SBP approved Domestic Payment Scheme (DPS) Card as the default card at the time of issuance or renewal of debit cards.

2.3.2 Standardization of QRs – First step towards achieving QR payments Interoperability

Keeping in view the merchant profile in the country, it is not feasible for many small merchants working at small margins to deploy POS machines that have high variable costs. One of the alternative ways to address this situation is to promote acceptance of payments through QR codes. Although QR codes have been deployed in substantial numbers in the country, the volume of transactions did not achieve desired levels mainly due to their lack of interoperability.

Therefore, as a first step towards achieving interoperability, SBP advised all QR code issuing and/or acquiring institutions to adopt EMVCo's QR Code Specifications. This is expected to enable financial institutions to innovate and expand their acquiring business without creating proprietary systems/schemes and provide a foundation to achieve inter-scheme interoperability.

2.3.3 Digital Onboarding of Merchants

SBP issued rules for Digital On-boarding of Merchants to facilitate growth of digital payment acceptance points in the country. The rules provide minimum requirements for simplified due diligence process of on-boarding individual and self-employed persons as merchants, services to be offered by merchants, transaction limits, maximum account balance limits, security measures, dispute resolution mechanism, etc. These rules are designed to facilitate the acquiring institutions to onboard small retail merchants seamlessly and enable them to accept their payments digitally, thus providing new payment options to consumers and broadening the financial inclusion base in the country.

2.3.4 Regulatory Measures to Promote Digital Payments during COVID-19 Pandemic and other Initiatives For Promoting New Technologies

During FY20, COVID-19 brought new unforeseen challenges to the mix which has drastically impacted the global financial industry. SBP, after consultation with stakeholders, instructed regulated institutions to provide their services seamlessly by reducing the risk to customers' exposure amid the pandemic. The objective of these measures is to reduce the need for visiting bank branches or the ATMs and to promote use of digital payment services such as internet banking, mobile phone

banking, etc. The regulated entities have also been advised to increase their cyber-resilience keeping in view the expected increase in the usage of digital financial services. These measures include:

- **Waiving Charges for Online Fund Transfers:** SBP, in order to facilitate transactions through digital means, has waived all the transactional fees charged by regulated financial institutions against all the fund transfers through online channels. SBP also waived charges against all customer transfers performed through SBP operated Real Time Gross Settlement System (RTGS). Further, to enable easy on-boarding of customers on online banking channels, SBP has waived the requirement of biometric verification for activation of internet and mobile banking, till further instructions.
- **Measures to Enhance Cyber Resilience amid COVID-19 Threat:** SBP taking proactive steps, issued instructions to the industry to ensure continuity of business and operations, exercise due diligence and implement stronger and robust cyber security measures to protect their customers from the risks associated with cyberspace during the coronavirus pandemic. The steps taken by SBP to increase cyber-resilience include instructions for work from home and access of critical infrastructure under prescriptive conditions, effective sharing of cybersecurity and threat related information, establishment of Cyber Threat Intelligence Units and deployment of Emergency Response teams, etc.
- **Facilitation regarding Paper-based Clearing Operations:** In order to address the financial needs of customers due to reduced operating hours of banks, SBP introduced Direct Cheque Deposit Facility, which reengineered the whole process of clearing of cheques. Under this facility, the customer instead of going to their Drawee/account maintaining branch, can present a crossed-cheque to any branch of the paying bank, in order to have immediate transfer of funds to their accounts. SBP has also allowed banks to provide following services to their customers:
 - (i) Doorstep Cheque Collection Facility and Drop box Cheque Collection Facility
 - (ii) Clearing of scanned image of cheque for priority/corporate customers and Image Based Clearing (IBC) functionality
- **Facilitation of EMIs, Payment System Operators and Payment Service Providers:** In order to foster innovations in payments by use of technology and provide enabling regulatory environment to non-bank entities, SBP further strengthened the already laid building blocks for payment service providers, by introducing Regulations for Electronic Money Institutions last year. Since then, SBP has received tremendous response as it has provided a new space to numerous FinTechs operating in Pakistan.

Since the launch of EMI regulations, SBP processed six applications for an EMI license, out of which three EMIs have started their pilot operations and are on track to launch their operations on a commercial scale, in the coming few months. The rest of the three (03) EMI licensees have been given in-principle approval and are soon expected to start their pilot operations as well. It is quite promising to see that many more international and local FinTechs have shown interest for a

potential EMI license in Pakistan, with a vision to provide pioneering payment solutions and digitization of the economy.

In addition of facilitating the EMIs, SBP also enabled PSOs and PSPs to offer White label ATM⁵ services, payment initiation and account aggregation services and e-payment gateway services to promote innovative payment products and services in the country.

- **Improving Large Value Payment and Settlement System:** In addition to the setting up MPG, SBP also laid down the foundation to improve the large value payment systems of the country. Under the World Bank's Financial Inclusion Infrastructure Project (FIIP), SBP decided to replace the current RTGS (the only large value payment system in the country) with an Automated Transfer System (ATS+) with an ACH system to bring efficiency in the large value settlement systems of the country, enabling SBP to facilitate the settlement of securities and transactions performed through the Micropayment Gateway and other ancillary systems in Pakistan.
- **Strengthening the Legal & Oversight Framework in line with National Payment Systems Strategy:** The payment systems play a vital role in improving the financial stability, economic growth and monetary policy objectives of any country. But the strength is certain to change into a weakness, when the legal and regulatory landscape is not sufficient enough to keep up with the ever evolving pace of payment system innovations. This has been recognized in the recently launched NPSS, whereby one of the major recommendations is to review existing legal and regulatory framework of the payment systems of the country, identify gaps and subsequently fill these gaps by suitable amendments in the legal and regulatory framework of the country. SBP has finalized the procurement process to acquire services of a competent legal consulting firm, with support from World Bank under the Financial Inclusion Infrastructure Project (FIIP).

2.4 Developments in Government Payments

During FY20, SBP intensified efforts to digitize government receipts and payments. In order to bring the cost of digital tax payments and manual paper based tax payment, the nominal fee on digital payment of taxes on the tax payers was eliminated which would be absorbed by SBP. As the fee is nominal as compared to the agency commission, the SBP pays to agent banks for traditional paper based tax collection, the absorption of digital tax payment fee by SBP, will in fact reduce the net cost of tax collections for SBP. Further, in a significant development in this respect, timelines were agreed with FBR to gradually eliminate the manual tax collections by January 2021. As a first step in this direction, the option of manual tax payment by corporate sector was eliminated from August 2020.

2.4.1 Collection of Government Taxes and Fees through ADCs

The Alternate Delivery Channels (ADC) system for collection of government taxes is functioning and robustly for different agencies of GoP and Government of Punjab. The taxpayers pay their taxes through internet banking, mobile banking, ATMs and Over-the-Counters (OTC) facility of branches of

⁵ White Label ATMs are owned and operated by non-financial entities.

commercial banks across the country. Since its launch in March 2018, an aggregate amount of Rs.829 billion of government taxes and duties has been collected. In order to promote digital payments of government taxes and duties, SBP with effect from January 1, 2020, eliminated the transaction fee for taxpayers using digital modes for payment of duties and taxes of federal and provincial governments. Further, to utilize the potential of ADCs system fully, SBP and FBR have agreed to gradually replace the manual payments of FBR's taxes with the ADCs system starting with corporate taxpayers from Q1 of FY21. Accordingly, payments of FBR's Taxes by AOPs/Partnerships and individuals will be shifted completely on the ADCs in the Q2 and Q3 of FY21 respectively.

Similarly, SBP is negotiating with other provincial governments to use this facility for their taxpayers and utilize the umbrella of ADCs for collection of their taxes and levies. Recently, SBP, M/s 1Link and Islamabad Capital Territory Administration (ICTA) have executed a tripartite agreement for extension of ADC system for collection of ICTA taxes and duties. While negotiation with Finance Department, Khyber Pakhtunkhwa are at advance stage for initiation of online collections, negotiation with other provincial governments will be initiated in FY21. The project will be broadly based on the model already implemented for FBR and Government of Punjab.

2.4.2 Automation of Duty Drawback Refunds

After digitization and automation of Person to Government (P2G) payments, SBP and GoP are now working on digitization of Government to Person (G2P) payments. As a part of G2P digital payments, SBP and Pakistan Customs are working on digitization of Duty Drawbacks refunds to business in the first phase. After digitization of this process, Customs will generate and deliver a message to SBP for payment of refunds directly into the exporter's bank account upon realization of foreign exchange proceeds of export consignment. The successful implementation of this project will be a milestone towards digitization of G2P payments and will help in the government's initiatives for ease in doing business.

2.5 Ensuring Quality of Banknotes and Efficiency of Currency Management System

SBP Vision 2020 envisions availability of clean and good quality banknotes with state of the art security features and automation of currency management system. In this context, the Bank initiatives included implementation of Currency Management Strategy (CMS), introduction of latest security features in banknotes and exploring innovative techniques to improve the quality and durability of banknotes. Subsequent to the implementation of CMS, good quality banknotes remains in the circulation.

2.5.1 Implementation of Currency Management Strategy

SBP introduced the Currency Management Strategy (CMS) in 2015 which inter-alia aims at reforming the currency management function from manual to automated environment, standardization of packaging and transportation of banknotes. Subsequent to the successful implementation of CMS, now all commercial banks' branches and ATMs are disbursing machine authenticated banknotes of Rs 100 and above denominations. The scope of the strategy would be enhanced to include machine processing of Rs 50 banknotes by January 2021. In order to standardize the banknotes packaging practices across the industry, commercial banks are following SBP's Banknote Packing Instructions (BPI) for packing of all banknotes denominations. It is worth mentioning that banks have installed

8,265 banknotes authentication machines and 8,047 banknotes packing machines which are deployed at CPCs and standalone branches. It is further stated that banks have established 709 Cash Processing Centers (CPCs) which are providing machine processed banknotes to 9,604 bank branches. Banks have equipped 5,665 branches with the individual banknotes processing machines to meet their own needs. Moreover, 550 bank branches have made arrangements with other banks for the provision of machine authenticated banknotes.

2.5.2 Banknote related instruction issued during the COVID-19 pandemic

In wake of the COVID-19 pandemic, SBP has issued special instructions to the banks to aid in the efforts to contain the spread of the disease. Banks were advised to take additional precautionary measures with regards to disbursement and collection of cash. In this regard, SBP has mandated a fourteen (14) day quarantine period for all banknotes received by the bank before their re-issuance to customers and the public. Furthermore, banks have been instructed to make special arrangements for the collection of the cash received from Hospitals and Clinics. The same may then be disinfected, sealed, secured and quarantined separately.

The SBP has also advised banks to preferably issue banknotes received from SBP, or fresh/unissued banknotes. Banknotes received from the public, may only be re-issued as a last resort, only if the banknote have been kept by the bank for the prescribed quarantine period.

2.6 The Way Forward

SBP, in its intent to adapt with the changing payment systems dynamics, envisages upon gradually building an environment of digitization which will not only entail the benefits of transparency but also economic growth. In the next steps, SBP plans to implement the action items identified in NPSS with particular focus on enhancement of legal and oversight of payment systems, digitization of government payments, increasing access points and facilitation of FinTechs in the country. Further, SBP also aims to enable the industry to utilize the services of cost effective cloud based services and enhance cyber security of payment systems.

SBP is also working with some banks to provide Digital Accounts to Overseas Pakistanis under which Non Resident Pakistanis (NRPs) would open accounts digitally/remotely in Pakistani bank through online portals and use online banking and avail lifestyle banking product suite. SBP in a continuous effort is working to strengthen and develop new policies to support the FinTechs, EMIs and banking and financial industry that would help to accelerate the digitization of payments landscape in the country.