

3 Strengthening Financial System Stability and Effectiveness

Smooth functioning of the financial system is an essential condition to build confidence of the market participants and enable them to play their role in efficient resource allocation. Ensuring financial system stability requires SBP to remain vigilant and cognizant of the emerging challenges and risks and take proactive policy measures. In this perspective, SBP has further strengthened its regulatory and supervisory framework. Some of the key achievements during FY20 included establishment of National Financial Stability Council, publication of Financial Stability Review, surveys to assess risks emanating from COVID-19, revision of stress testing guidelines, enhancing macro stress testing regime and conducting the first joint industry-wide Business Continuity Planning (BCP) drill.

3.1 Institutionalization of Financial Stability Framework

3.1.1 Establishment of National Financial Stability Council

A well-structured institutional set-up is essential for an effective Macroprudential Policy Framework (MPPF). Towards this end, SBP in collaboration with Securities & Exchange Commission of Pakistan (SECP) and Ministry of Finance (MoF) established the National Financial Stability Council (NFSC). The Council is envisaged to deliberate on the issues and trends in the financial system affecting financial stability and responding to the threats appropriately. It also aims at enhancing the inter agency collaboration to provide coordinated responses to systemic risk especially those with cross-system implications.

3.1.2 Financial Stability Review, Half-Yearly Performance Review and Quarterly Compendium

SBP issued its flagship publication, “Financial Stability Review (FSR)” for CY19 in June 2020. The review presents performance and risk assessment of various segments of the financial sector including banks, non-banking financial institutions, financial markets, non-financial corporates and financial market infrastructures. The emerging challenge posed by COVID-19 outbreak and the mitigating measures undertaken by SBP to limit its adverse implications, for the economy and the financial sector, have also been covered in the report.

During FY20, SBP published Mid-year Performance Review of the banking sector, for the period, January-June 2019. Further, SBP continued to disseminate financial sector’s data through regular publication of Quarterly Compendium (QC) Statistics of the Banking System. The Compendium includes data of commercial banks, Islamic banks, MFBs and DFIs.

3.1.3 Risk Surveys

SBP conducted 4th and 5th wave of Systemic Risk Survey (SRS), respectively, in July 2019 and January 2020. SRS helps gauge the views of market participants and experts about various existing and emerging risks that can potentially undermine the stability of the financial system.

In order to assess the implications of the COVID-19 pandemic for financial institutions and to firm up policy response, SBP conducted two surveys in the month of March and April 2020. Based on the first

survey results, SBP issued an advisory circular to ensure the availability and continuity of financial services.

3.1.4 Strengthening of Consolidated Supervision Framework

SBP has been conducting the consolidated supervision of banks to assess their financial health and key risks at group level. For this purpose, a dedicated Joint Task Force of SBP and SECP is working to monitor and manage the risks posed by conglomeration in the financial sector. Both the regulators recently reviewed and updated the Terms of Reference of the task force to better achieve the underlying objectives and address changes in the dynamics of the financial system. During FY20, the SBP developed a quantitative criterion to supervise and assess the banking groups on consolidated basis.

3.1.5 Assessment of Banks' resilience through Stress Testing

SBP uses various stress testing approaches to assess resilience of banks against hypothetical but plausible extreme conditions, which include single-factor sensitivity analysis and multi-factor dynamic macro stress tests. During FY20, forecasting and scenario analysis suite of econometric models has been strengthened by including Bayesian Vector Autoregressive (BVAR) models. Based on the results of these stress-testing exercises, supervisory departments of SBP engage with banks exhibiting capital shortfall. Stress testing exercise is also an integral part of SBP's annual publication, Financial Stability Review (FSR), where resilience of banks is assessed against domestic and foreign risk factors. The FSR for FY20 focused upon assessment of banking sector resilience against economic and financial vulnerabilities, giving special emphasis to COVID-19. Further, stress testing framework is being regularly upgraded in line with the latest developments in the area.

3.1.6 Revision of Stress Testing Guidelines

The Stress Testing Guidelines (STGs), first issued in 2005, were revised in 2012. The SBP, in pursuance of its goal to further strengthen the risk management capacity of banks, DFIs and MFBs, updated the existing guidelines on Stress Testing to align with the changing local dynamics and international best practices.

The scope of revised ST guidelines has been broadened to incorporate guidance on Scenario Analysis, aka Macro-stress Testing (MST) and Reverse Stress Testing (RST) besides the Sensitivity Analysis (SA) with enhanced number of shock scenarios. In terms of coverage, besides banks/DFIs, Islamic banks, Islamic bank branches (IBs/IBBs) and micro-finance banks (MFBs) are required to conduct SA exercise. Further, the sample of Domestic Systemically Important Banks (D-SIBs) are required to compulsorily conduct MST and RST and report it as part of their Internal Capital Adequacy Process (ICAAP) document. Finally, the data submission requirements have been rationalized and financial institutions are now required to furnish data on a minimal number of variables.

3.1.7 Assessment of Relevance and Implications of Counter-cyclical Capital Buffers in Pakistan

The macro-prudential policy framework (MPPF) ensures system-wide stability of the financial sector. To enhance its assessment of pro-cyclical systemic risk capabilities, SBP substantially improved its macro stress-testing regime to capture the macro-financial interlinkages. Moreover, a number of variables have been identified as Early Warning Indicators (EWIs) of systemic risk. To further

strengthen its assessment and identification of build-up of systemic vulnerabilities due to business cycles, SBP undertook an empirical study to identify the periods of risk excesses and assess the need for building resilience of the banks against such systemic risks.

To this end, the gaps of broader and narrower measures of credit, namely, the credit to private sector (CPS) and advances (ADV) of the banking sector have been used as risk indicators. Besides normalizing these measures by GDP, the deviations of the growth rates of *real* and *nominal* values of the two credit measures from trend have also been used. In terms of methodology, three filtering methods have been deployed i.e. two-sided and one-sided versions of Hodrick-Prescott (HP) Filter as well as Christiano-Fitzgerald Filter.

The indicators used to gauge the excesses could identify a few episodes of credit excesses, which are followed by economic downturns. The banking sector's behavior with respect to capital has been found to be pro-cyclical, which effectively results in banks shunning the credit disbursements during downturns. Further, the infection ratios increase during the economic downturns while subside during upturns – at least during last two decades.

3.1.8 Crisis Preparedness Initiatives

The financial systems remain expose to operational disruptions due to wide-spread natural disasters and man-made threats. International standard setting bodies encourage banks to have an effective Business Continuity Regime.⁶ Bank for International Settlement (BIS) encourages financial authorities and key financial industry participants to run market or industry-wide tests to assess the level of resilience across markets and the compatibility of the recovery strategies of individual market participants. In this backdrop, SBP conducted the first joint industry-wide Business Continuity Planning (BCP) drill under a carefully designed scenario. The BCP/DR drill was successfully conducted on December 07, 2019. The scenario envisaged that the primary sites for some critical functions related to payment system of all banks, 1-Link⁷ (Payment Service provider) and SBP became inaccessible due to some disaster. As a result, all the participants moved to their BCP sites. SBP and 1-Link also transferred their respective systems to DR servers and banks accessed their systems and platforms from BCP/ DR sites. This was a mock exercise that generated a host of data and information regarding readiness of BCP/DR sites and effectiveness of business continuity plans that would be helpful in forming industry's future response to a crisis.

A well-functioning financial safety net is crucial for preserving and promoting the financial stability in the economy. The Lender of Last Resort (LOLR) facility is an integral element of financial sector safety net, as it helps a bank in overcoming short-term liquidity strain and thus prevents any panic among depositors and contains the possibility of bank run and contagion risk. As per the requirement of Section 17-G of the SBP Act, 1956, SBP is working on the development and implementation of an operational framework for the LOLR facility.

⁶ Please see "Guidance on Arrangements to Support Operational Continuity in Resolution", FSB, August 2016

⁷ 1-Link is an authorized payment system operator/payment service provider.

3.1.9 Cooperation in Banking Supervision

As part of its efforts to share information and contribute to various regional and international studies, SBP provided its feedback on various international surveys and consultative documents e.g. FSB Survey on Cyber Incident Response and Recovery, World Bank Survey on Interest Rate Controls, etc. SBP has also updated the 2019 IMF Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) and the Macroprudential Policy Survey. The Macroprudential Policy Survey collect information on measures that have been adopted with the objective of containing systemic risk and on the institutional aspects of the macroprudential policy framework in member countries. In addition, SBP provided updates to the Financial Stability Board (FSB) on SBP's COVID-19 related policies and measures. SBP has also participated in FSB Regional Consultative Group for Asia (RCG Asia) Conference Call where the impact of COVID-19 on the Asian region was discussed, along with other financial stability issues such as Cyber incident response and recovery.

3.2 Progress towards Risk Based Supervision

Development of Risk Based Supervision (RBS) framework continued with steady pace. SBP has engaged Toronto Centre (TC) under the Long Term Country Engagement (LTCE) program for development & implementation of RBS Framework whereby five capacity building sessions have been conducted by TC experts till date. RBS, being a forward-looking framework, will help in better understanding of a bank's risk profile with reference to both external and internal risks. This, in turn, will facilitate the supervisors in early identification of problems, efficient deployment of supervisory resources towards riskier areas and initiating prompt corrective actions. A pilot testing of certain significant activities in two selected banks, on recommendation of TC experts, to fine tune the developed methodologies were conducted. Capacity building of supervisory resources is also being carried out through a series of training sessions. In addition to internal stakeholders, awareness sessions were also conducted for selected key executives of FIs in order to achieve seamless supervisory transition.

3.3 Strengthening Regulatory Framework

3.3.1 Revision of Branchless Banking Regulations

To increase outreach of BB operations for achieving the objective of financial inclusion and strengthening the controls related to Money Laundering (ML)/ Terrorist Financing (TF) risks SBP revised the Branchless Banking (BB) Regulations for Financial Institutions (FIs) in December 2019. The key highlights of the revised regulations include phasing out of Person to Person transfer till June 30, 2020, enhancing per month transaction limit of BB level "1" account to Rs.200,000, mandatory biometric verification of legacy BB level 1 accounts and risk assessment of BB Operations by FIs.

3.3.2 Regulations for Digital Onboarding of Merchants

To facilitate growth of digital payment acceptance points in the country, SBP issued Regulations for Digital on-boarding of Merchants for Banks/MFBs. The key features of these regulations include minimum requirements for simplified due diligence process of on-boarding individuals and self-employed persons as merchants, transaction limits, maximum account balance limits, security measures, dispute resolution mechanism etc. Further, SBP also advised Banks/MFBs to ensure that

these accounts would be only used for digital collection of payments against the provision of legitimate goods and services.

3.3.3 Guidelines on transfer of Non-Performing Assets to Corporate Restructuring Companies

SBP issued guidelines for “Transfer and Assignment of Non- Performing Assets to Corporate Restructuring Companies”. This will address the issue of growing size of non-performing loans in the banking industry.

3.3.4 Measures Related to COVID-19

To dampen the adverse effects of COVID-19 on the economy and ensure continuous provision of banking services throughout the country, SBP took a number of measures some of which are detailed below:

- To enable the customers to open and use BB platform, the deadline of Biometric Verification of legacy BB Level-1 accounts was extended till September 30, 2020. SBP encouraged the Authorized Financial Institutions (AFIs) to introduce Biometric Verification through smart phone applications and use digital channels for BB agents’ onboarding with an objective to increase financial services access points.
- To ease out borrowers’ repayment capacity, Banks/DFIs were advised to defer repayment of principal loan amount for one year upon written request of the obligors received by September 30, 2020 including the repayment of Sukuk and Term Finance Certificates as well.
- Banks/DFIs were allowed to recognize impairment loss, if any, resulting from the valuation of listed equity securities held as ‘Available for Sale’ (AFS) in phased manner equally on quarterly basis during calendar year ending December 2020.
- Banks/DFIs were allowed to take exposure against the shares issued by its group companies to ease out the liquidity requirements of the companies
- The criterion for classification of “Trade Bills” was relaxed by six months till September 2020.
- To support the banking sector to supply additional loans to businesses and households, Capital Conservation Buffer (CCB) was reduced from 2.5 percent to 1.5 percent. This relaxation made available approximately, an additional Rs.800 billion for lending/investments.
- The regulatory retail portfolio limit of Rs.125 million was enhanced to Rs.180 million to support the growth of credit to the retail sector and small & medium enterprises.
- To minimize the risk of exposure to COVID-19 and save the transaction time of public, the Banks were advised to maintain separate list for closed branches along with the addresses of nearest operational branches at prominent place on their website.
- Debt Burden requirement was relaxed for consumer loans from 50 percent to 60 percent. This measure enabled approximately 2.3 million individuals to borrow more from banks.
- Margin requirement on exposure against shares of listed companies was relaxed from 30 percent to 20 percent and margin calls from 30 percent to 10 percent to counter volatility in the Pakistan Stock Exchange.

3.3.5 Implementation of IFRS 9

To comply with the International Financial Reporting Standard 9 (IFRS 9), SBP advised the banking industry to prepare IFRS 9 compatible pro-forma Financial Statements for year-ended 2019. It was also advised to initiate parallel run of IFRS 9 during FY20, which would pave way for full implementation of IFRS 9 in Pakistan from January 2021.

3.3.6 Enhanced Disclosure Requirements for Banks in Financial Statement

The financial statements are the main source of information for public at large. To enhance the transparency in banks' affairs and to boost the confidence of stakeholders in banking system, SBP revised the format of interim financial statements (quarterly and half-yearly) of banks. The new format is compatible with the best international practices of disclosures and will present banks' business performance and value in a clear and concise manner.

3.3.7 SBP AML/CFT Regime

To further align AML/ CFT Regulations with the recommendations of Financial Action Task Force (FATF) and to bridge the gaps identified in Pakistan's Mutual Evaluation Report, SBP made some important amendments in its regulatory framework. The introduction of amendments will provide further clarity on implementation of AML/ CFT requirements through Risk Based Approach (RBA), customer due diligence (CDD), Targeted Financial Sanctions (TFS) on Terrorism Financing and Proliferation Financing (PF), reporting of STR/CTR, record keeping, identification of ultimate beneficial ownership and politically exposed persons (PEPs), correspondent banking and wire transfers/ funds transfers.

3.3.8 Branch Network Expansion

To enhance outreach of financial services to the general public, SBP issued approximately 800 new branch licenses to commercial banks/microfinance banks during FY20. Out of these new branches, at least 23 percent of branches are opened in rural, underserved and unbanked areas. Special focus remained on the priority areas of Balochistan, Khyber Pakhtunkhwa, AJK and Gilgit Baltistan for which 164 new branches were approved during FY20.

3.3.9 SAARC Finance Seminar on Emerging Trends in Good Governance

SBP successfully hosted a three-day international SAARCFINANCE Seminar on 'Emerging Trends in Good Governance of Banking Sector in SAARC Region' during December 2019 at NIBAF Islamabad. The seminar was mainly organized to highlight the importance of efficient and robust governance structure in the banking industry for sustainable economic growth of a country. Besides dignitaries from Pakistan, the seminar was also attended by delegates from Afghanistan, Bangladesh, Bhutan, Sri Lanka and Nepal.

3.3.10 Role in Privatization Program

SBP is actively facilitating the privatization of state owned financial institutions i.e. SME Bank, FWBL and HBFCL in order to realize non- fiscal proceeds and address continuous burden on exchequer.

3.3.11 Raising Additional Tier 1 capital through foreign sponsors

To encourage further investment in the capital instruments, SBP allowed banking industry with majority foreign shareholding (more than 50 percent) to raise Additional Tier 1 capital in the form of Foreign Currency (FCY) subordinated debt/ loan from their existing foreign sponsors.

3.4 Supervisory Initiatives

In line with the SBP Vision 2020, SBP undertook various developmental initiatives to enhance effectiveness and operational efficiency of the inspection process.

• Updation of AML/CFT Inspection Framework & Manual

Pakistan has been under Financial Action Task Force (FATF) action plan since June 2018. As the action plan was focused on “effectiveness” component of the recommendations, an internal action plan was developed and dedicated specialist resources were deployed for the same. Further, the IMF - Technical Assistance in the area of AML/CFT also suggested revisions / additions in the existing supervisory framework relating to the risks in the areas of ML/TF and PF. The following activities were also undertaken to enhance the AML/CFT regime:

- Updated the existing ML/TF and PF risk assessment methodology under the broad mandate of Risk Based Supervision.
- Updated AML/CFT Inspection Manual in the light of the latest developments.
- Derived risk rating through ML/TF and PF Risk Assessment Framework to determine the frequency and intensity of inspections.
- Revised likelihood ratings of inherent risk in light of National Risk Assessment - 2019.
- Developed factors for categorizing High Risk Geographies for both domestic and international.
- Developed checklist and red-flags for assessment of transnational risk pertaining to ML/TF emanating from and impacting the banking industry.
- Developed a process to identify significant emerging risk in the area of ML/TF/PF.
- Developed a mechanism to incorporate vulnerabilities identified in NRA in the supervisory assessments methodology.
- Addition of structural risk component in inherent ML/TF/PF risk rating methodology.
- Development of questionnaire for off-site assessment of controls of FIs.

• Inspection Methodology for PSO/PSP and EMI

SBP granted licenses to Payment Services Providers/Payment System Operators (PSO/PSPs) in line with rules issued for PSO/PSPs in 2014. Moreover, Electronic Money Institutions (EMIs) regulations were issued in 2019 and process of granting in principle approvals to interested entities for establishing EMIs has been initiated. In view of the developments, SBP decided to develop a comprehensive Inspection Manual. The focus of the inspection methodology is to identify key risks in activities performed by PSO/PSPs and EMIs and controls implemented by them to mitigate associated risks while ensuring broader objectives of financial inclusion and customer protection.

- **Revamping the Methodology for Inspecting Banks' Operations**

In order to bring efficiency in the inspection process, initiatives were undertaken to revamp the Methodology for inspecting banks' operations. The objective was to make optimum use of data relating to AML/CFT and general banking operations available with the bank in electronic form and transform present Bottom-Up approach of inspection, largely relying on transaction testing, to a Top-Down approach based on extensive data analysis. The revised methodology broadly consists of data procurement through standardized data tables, analytical tools to analyze the data and predefined set of red flags, which identify grey areas requiring inspection focus. The mechanism will augment pre-inspection planning of examining ML/TF risk and overall general banking operations and help allocate supervisory resources towards high risk areas. The revised methodology, after development, is in pilot test phase.

- **Parallel Run of "Assessment of Credit Risk through Red Flag System"**

In order to bring efficiency in the process of review of quality of assets of Banks, DFIs and MFBs, a developmental project of "Revamping the Process of Inspection of Assets Quality" was carried out in FY 19. This was in line with Strategic Goal of SBP's Strategic Plan 2016-20. The revised inspection methodology takes into account the 'Top-down Approach' by analyzing the overall quality at portfolio level, through Red Flag Utility and thereby identifying major risky areas for further detailed review. In order to ensure comprehensive testing before full implementation of the revised methodology, parallel run was carried out in various banks during FY20. The results of Red Flag Utility, in cases where correct data was available, were found to be at par thereby endorsing the correct working of Red Flag System concept.

- **Implementation of Team Spaces in KM ECM System**

SBP successfully implemented Team Space functionality for its inspection teams. It is designed to work as a Private Cloud Service (SBP access only) wherein data and information is shared among members of an inspection team. Besides, availability, integrity and confidentiality of data, this system addressed the challenge of loss of data due to any adverse scenario. With the implementation of this system, the officers while working from home, can place their data securely on this corporate cloud and when needed share it with other officers, with complete control on access management.

- **Implementation of Workflow System for Managing Internal Cases**

SBP successfully implemented Internal Case Management System (ICM) which is a workflow system for processing internal cases using electronic means and hence contributed significantly towards paperless environment. The system covers complete life-cycle of internal case processing. Using the system, now all cases of the departments are processed electronically i.e. noting, approvals, obtaining and sharing feedbacks from/with other departments or sending inter office memorandums.

3.4.1 On-site Inspections

The Banking Inspection Departments undertake onsite inspections to assess the safety, soundness of the financial institutions as well as their compliance with applicable laws and regulations. The supervisory objectives are achieved through conducting full scope, limited scope, thematic, focused inspections and special investigations. During FY20, on-site inspections of Banks, DFIs, MFBs and Exchange Companies were conducted as per approved inspection plan. Areas of supervisory concerns

which, inter alia, included assessment of corporate governance, weaknesses in systems and controls, cyber security, compliance with AML /CFT regime and business conduct etc. were taken up with the banks' BoDs and senior management for corrective actions. In addition, statutory reports on written-off loans and advances were prepared as per the requirement of section 25AA of the BCO, 1962.

3.4.2 Thematic Inspections

Thematic inspection is a supervisory tool which focuses on assessment of risks in a particular business activity across banking industry. Onsite thematic inspections are used to identify inherent risks due to non-compliance with regulatory regime or adverse practices in specific area across industry and to facilitate issuance of further guidance or direction to the industry besides enforcement action against non-compliant institutions. During FY20, following thematic inspections were carried out:

- **Assessment of High Risk Customers in High Risk Geographies**

To assess the preparedness and robustness of banks' systems and controls to mitigate TF risk in dealing with these high risk customers in high risk geographies, thematic inspections were carried out. The National Risk Assessment for Terrorism Financing (NRA-TF) report identified various high risk threats including NPOs/ NGOs/ Charities/ Trusts, Afghan refugees/foreign nationals, extremist religious groups, Designated Non-Financial Businesses and Professions (DNFBPs), armed outfits of political parties/nationalist groups and employees of exchange companies posing significant Terrorism Financing (TF) risk to financial sector falling under regulatory ambit of SBP.

The objective of this inspection was to assess alignment of banks' policies and framework with the threats and vulnerabilities highlighted in NRA-TF. Besides, comprehensiveness of internal TF risk assessment, appropriateness of banks' strategies & oversight; effectiveness of devised deterrence measures; robustness of TF detection tools & techniques; transparency & adequacy of suspicious transactions reporting and capacity of relevant human resources was also reviewed.

- **Cyber Security Assessment**

During the last decade, higher reliance of FIs on information technology based platforms has increased vulnerability of country's financial system towards cyber exploits. Thus Cyber Security has become one of the serious concerns for SBP as well as for FIs. Accordingly, Cyber Security assessments were conducted during FY20. Preparedness of FIs in the area of Governance, Technology operations, ADC channels and Cyber security Operations with respect to emerging Cybersecurity and Technology Risk were assessed during the inspection. The scope also included to review implementation of basic pillars of Information/Cyber security (Confidentiality, Integrity and Availability) and rate the FIs with respect to its ability to investigate, detect, protect, respond and recover in case of cyberattack.

- **Review of NGO/NPO/INGO Accounts**

The objectives of inspection included assessment of adequacy of banks' policies/ procedures addressing risks emanating from NGOs, NPOs and charitable institutions' accounts operations, assessment of effectiveness of on-going monitoring including transaction monitoring mechanism and name screening process and review effectiveness of banks' controls related to KYC/CDD/EDD

including determination of the true identity of account holders/operators of the NGOs/NPOs/Charitable institution's accounts.

- **Review of Transaction Monitoring and Sanctions Screening Systems in Exchange Companies (ECs)**

Review of Transaction Monitoring and Sanctions Screening Systems in ECs was conducted to assess the effectiveness of the methods (system based & manual) adopted by ECs for identification of suspicious transactions and efficiency of Sanction Screening system/mechanism adopted by ECs. During the course of inspection, role of BoDs and senior management regarding monitoring TMS and name screening, comprehensiveness of relevant policies and effectiveness of TMS scenarios and other methods employed by EC for detection of suspicious transactions were assessed.

- **Inspection of Outlets of Exchange Companies in High Risk Jurisdictions**

The main objective of this inspection was to assess Money Laundering and Terrorist Financing risk of exchange companies through inspection of selected outlets located in border areas and effectiveness of the controls to mitigate those risks. The areas specifically focused during the inspection included role of BoDs and senior management regarding oversight of affairs of the business outlets, comprehensiveness of the relevant policies/procedures and effectiveness of compliance, internal audit and systems/mechanism to mitigate ML/TF risk.

3.4.3 Limited Scope Special Inspections

- **Assessment of Controls related to AML/CFT**

Thematic inspection of selected banks/DFIs were carried out to assess the oversight and controls related to AML/CFT in line with the revised ML/TF risk assessment methodology. The objective was to review controls and oversight of the institution to assess, monitor and mitigate ML/TF risk emanating from the FI's activities including customers, products, channels and geographies. Effectiveness of BoD and management oversight, adequacy and effectiveness of CDD & AML/CFT policies & procedures, effectiveness of Name screening & Transaction Monitoring System, assessment of measures taken by the FIs to mitigate ML/TF risks including the transnational TF risk and adequacy and effectiveness of Compliance and Internal Audit functions were assessed during the inspection.

- **Monitoring of AML/CFT regime of SBP:**

In order to ensure that banking channel is not used for ML/TF, SBP has taken banking sector-wide measures. These initiatives have been taken as part of SBP's strategic goal regarding, 'Strengthening and streamlining the regulatory and supervisory framework':

- **Biometric verification of banks accounts:** As a result of supervisory follow up on instructions issued by SBP, 98 percent of banking industry's customers' (active) accounts have been validated through the use of biometric technology by May 2020. The exercise aims to alleviate FATF concerns regarding Pakistan's effort to fight money laundering and boost country's image and economy.

- **Assessing effectiveness of regulatory regime on AML/CFT:** To assess the effectiveness of SBP instructions in improving compliance of regulatory requirements on AML/CFT, banks are regularly reporting data on existence of policies and procedures on a prescribed template. Major areas covered in the template include oversight of senior management/Board, role of internal audit, compliance, name screening systems, transaction monitoring system, mechanism of reporting of suspicious transactions, data cleansing exercise and capacity building. The positive impact of rigorous off-site monitoring is visible in upgraded areas such as IT systems, data cleansing, HR, STR reporting and internal risk assessment functions.

3.4.4 Capacity Building of Staff

Keeping in view the supervisory transition to RBS Framework, capacity building program for supervisory officers was initiated through a series of training module. The contents of the training module not only covered the assessment methodologies, but case studies and exercises were included to give participants a flavor of practical implications under RBS supervisory regime. Further, awareness sessions for selected key executives of FIs were also conducted wherein broad contours of RBS framework and supervisory expectations were discussed.

With increasing emphasis on AML/CFT, SBP undertook capacity building of officers through internal resources. Furthermore, two capacity building sessions were conducted for officials of banks on risk based approach for applying AML/CFT controls. A session was also conducted for the officials of Law Enforcement Agencies on the National Risk Assessment and the legal frameworks relating to Pakistan's AML/CFT regime.

3.5 Enhancements in SBP's Conduct Regulation and Supervisory Regime

SBP has been making efforts to enhance banking conduct and consumer protection regime under SBP Vision 2020. Some of the key milestones in this regard, achieved during FY20 are as under:

3.5.1 Review of Complaints against Banks/DFIs/MFBs

SBP has put in place effective and efficient consumer grievance handling mechanisms and Fair Treatment of Consumer (FTC) regime. During FY20, SBP conducted four years (2016-2019) review of consumer complaints against Banks/MFBs/DFIs to have insights on complaints management trends. The analysis was reviewed at the level of the Board of Directors of SBP. The salient features of the review have been published to emphasize SBP's narrative that responsible complaint handling is the core element of FTC and to boost banks' performance in handling complaints. Further, various measures were taken to increase awareness of banking consumers.

3.5.2 An integrated approach for Improvement of Complaint Handling Mechanism at banks

SBP has taken up a project in October 2019 to review the complaint handling mechanism at banks in more detail and to develop an integrated approach for sustained improvement in complaint management at banks. The project is being executed in collaboration with other departments within SBP. The project focuses on the assessment of ease of lodgment of complaints with banks especially for vulnerable segments of society including disabled, illiterate, women in rural areas, senior citizen, etc. recording of complaints in the system, processing of complaints as per TATs, root cause analysis and corrective actions taken by the banks. In the first stage completed in FY20, the data from the

banks was collected, which indicated deficiencies and inadequacy of staff in complaints handling divisions. In light of the findings, the deficiencies were taken up with the Presidents of the banks for taking corrective actions. Further, SBP conducted mystery calls to all banks/MFBs to assess the effectiveness of call centers in the lodgment of complaints. The project has now entered into second phase, where targeted inspection and mystery shopping will be conducted.

3.5.3 Conduct Assessment Framework (CAF):

SBP issued Conduct Assessment Framework(CAF) which comprises a separate module on dispute resolution mechanism whereby the banks are required to assess adequacy of complaint handling staff, visibility of complaint handling function, availability of escalation matrix, surveys on complaint handling, TATs, etc. CAF is a self-assessment tool, which is submitted to SBP after approval of the banks' board of directors. Meetings with all banks/MFBs were conducted during FY20 whereby the complaint handling module in CAF was discussed in detail and banks were advised to take initiatives to enhance their internal dispute resolution mechanism (IDR).

3.5.4 Consumer Grievance Handling Mechanism (CGHM)

In light of various enhancements in conduct regulatory corridor and use of technology in banking, a need was felt to introduce new categories in the complaint template for better analysis as the same was being reported in the miscellaneous category. SBP, after taking feedback from Pakistan Banks Association (PBA) and internal stakeholders revised the template with comprehensive coverage of complaint areas which will be issued in FY21. The new template will also cover details on the number and volume of transactions and aging of turnaround time.

3.5.5 Engagements and assistance

Given the globally growing focus on Financial Consumer Protection and Conduct Supervision, the related role of regulators has been largely revitalized. Resonating with the enhanced role to promote Fair Treatment of Consumer (FTC) and Responsible Banking Conduct, extensive engagements and review meetings were held with banks separately on various aspects of conduct including but not limited to complaint handling and conduct assessment framework. Further, several meetings were held with internal and external stakeholders for bringing synergies in conduct supervision regime. SBP also arranged awareness session at SBP BSC, Lahore and Sialkot to create awareness among consumers regarding complaint resolution mechanisms, availability of dispute resolution forums and rights and responsibilities as a banking customer.

Moreover, additional measures were taken to facilitate and assist customers on SBP's initiatives to dampen the effect of COVID-19 outbreak. The capacity of the helpline of SBP was enhanced to facilitate more people. Similarly, a separate email ID was created to respond to the specific queries and complaints on relief packages introduced by SBP in the wake of COVID-19.

3.5.6 Handbook on Conduct Regulations

SBP, being cognizant of the global trend and good practices, has undertaken a project to develop and issue a comprehensive Handbook on Conduct Regulations that will not only consolidate the conduct regulations at one place but also remove redundancies. The milestones set for FY20 have been completed.

3.5.7 Review of website management

The website, is one of the key customer touchpoints which needs management to reduce information asymmetries and other allied conduct risks. Given its vitality, SBP conducted a review of website management at banks covering areas of ‘Policy and oversight’, ‘Content development & management’ and ‘Monitoring and Improvements’. Data on these areas were acquired from banks through a questionnaire. Besides, the experiential aspects like website’s aesthetics, user/consumer friendliness and perception were covered through mystery monitoring of sampled banks. The recommendations of the review are in the process of implementation that will be completed next year. SBP is also responding and handling a large number of complaints through various channels including Pakistan Citizen Portal established by the Prime Minister Delivery Unit. The quantum of the complaints/queries have increased substantially in the wake of pandemic situation that were handled effectively and also recognized by the stakeholders.

3.5.8 Regulatory Enhancements in Private Credit Bureaus/Credit Registry-eCIB

- **Membership of Licensed Credit Bureaus**

Under the Credit Bureaus Act, 2015, all credit institutions are required to become a member of at least one licensed Credit Bureau. Accordingly, the existing Credit Bureaus Regulations, 2016 amended to allow membership of Credit Bureaus by all Credit Institutions to start sharing their consumers, commercial, SMEs, and corporate data. Resultantly, almost all Credit Institutions have become members of Licensed Credit Bureaus. The dissemination of Credit Information Report along with value added services and products by the licensed Credit Bureaus, would further strengthen Credit Reporting regime of Pakistan.

- **Use and Reporting of Alternate Data for Access to Finance**

Access to financing remains one of the most significant constraints for the survival, growth, and productivity of MSMEs and individuals. The access to finance to informal sector with no or thin credit history can be enhanced and expanded by promoting the use of alternate data in Credit Reporting. Efforts were made by SBP to allow utility companies to become a member of licensed credit bureaus and start sharing their data. At the initial stage, Telecom companies had to share their data. Subsequently, the companies supplying gas or electricity through distribution or transmission lines have to share the data enabling the licensed Credit Bureaus to analyze this data enabling the informal sector to develop their credit history to access to finance. Federal Government has issued requisite notifications in this regard.

- **Improvements in quality of data reported by FIs to eCIB-SBP**

SBP has been continuously monitoring the quality of data reported by the member FIs. SBP has recently undertaken an initiative of in-depth assessment of the Banks/DFIs/MFBs’ overall mechanism put in place for ensuring quality data reporting.

3.6 Other Initiatives

3.6.1 Ease of Doing Business (EODB) Index of World Bank

Since 2017, SBP is leading the reform efforts for improving Pakistan's ranking in the "Getting Credit" indicator of Ease of Doing Business Index of the World Bank. SBP has been actively collaborating with federal agencies, the World Bank and other stakeholders on implementation of reforms. SBP continued to focus on awareness and dissemination of relevant information amongst the stakeholders. SBP, in collaboration with SECP, World Bank and BOI, proposed legal amendments in the Financial Institutions (Secured Transactions) Act 2016 which were issued through a Presidential Ordinance in April 2020 to improve Pakistan's score in the Getting Credit indicator of the EODB index.

3.6.2 Consolidated List of SBP's Regulated Institutions on SBP Website

SBP regulates multiple categories of Financial Institutions (FIs) including Banks, Development Finance Institutions, Micro Finance Banks, Exchange Companies, Credit Bureaus and Payment System Operators/Payment Service Providers. The Basel Core Principles for Effective Banking Supervision (BCPs) require supervisors to ensure availability of current list of FIs, operating within its jurisdiction in a way that is easily accessible to the public. While information on SBP regulated entities was available on the website, it was in a scattered form. Accordingly, to align the availability of information with the BCP, SBP has made available the consolidated list of the regulated institutions at a single web link. Apart from the general information on contact details of the regulated entities, the consolidated list now provide additional information on the details of complaint handling units and licenses/authorizations/ permissions held by each of the institution.