POLICY BRIEF, JULY 2024

# The Regulatory Landscape for Fintech in Pakistan

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## Executive Summary

In Pakistan, fintech is reshaping financial services through technology, addressing traditional banking limitations and enhancing accessibility. Yet, significant challenges remain, notably the lack of robust data privacy regulations, which poses risks to consumer trust and cybersecurity in digital financial services while impacting innovation and investment in the fintech ecosystem. While regulatory bodies like the State Bank of Pakistan (SBP) and Securities and Exchange Commission of Pakistan (SECP) have frameworks in place, improvements are necessary. These include expanding the scope of innovation allowed in testing environments, establishing clear data governance within the regulatory sandbox, and implementing a tiered regulatory approach for Electronic Money Institutions (EMIs) to foster a resilient and inclusive fintech landscape in Pakistan, capable of driving sustainable economic growth and financial empowerment across all segments of society.

## Policy Recommendations

- Prioritise the enactment of Pakistan's Data Protection Bill (PDPB). The PDPB's consent requirements (Article 13) should be refined to ensure individuals freely give consent, mirroring the stricter standards outlined in GDPR Article 7 and it should clarify data protection restrictions as specified under GDPR Chapter V.
- Implement a tiered regulatory sandbox framework for fintech in Pakistan, similar to Singapore's MAS Fintech Regulatory Sandbox 2.0. This tiered approach can cater to various risk profiles and innovation types, fostering a more inclusive environment for financial innovation.
- The SECP should establish a transparent exit strategy for Pakistan's fintech sandbox, inspired by Hong Kong's model. A "Graduation Notice" outlining licensing procedures and regulatory requirements would ease the transition for graduating companies, fostering a more supportive environment for innovation.
- SBP should implement a tiered regulatory framework for EMIs similar to Malaysian SC's approach of categorizing EMIs based on size and complexity, fostering innovation for smaller players with simpler regulations while ensuring stability for larger institutions through stricter oversight.

- SECP and SBP can collaborate with the Pakistan Telecommunication Authority (PTA) and Ministry of Information Technology and Telecommunication (MoITT) to develop a multi-channel campaign to educate citizens about fintech benefits and responsible use.

## Fintech and its Relevance for Pakistan

Financial technology, or fintech, represents a pivotal transformation in how financial services are delivered and accessed globally as it involves the use of technology to improve and automate the delivery of such services[1]. In Pakistan, where traditional banking services have often been constrained by infrastructure limitations and accessibility issues, fintech presents a promising avenue for advancement.

According to reports by the State Bank of Pakistan (SBP), fintech adoption is steadily increasing, particularly in mobile banking and digital payments, which have the potential to significantly enhance financial inclusion[2]. According to the World Bank, as of 2021, approximately 87% of Pakistan's population had access to mobile phones, providing a strong foundation for mobile banking and digital payments to thrive.

Fintech adoption has also contributed to economic growth by facilitating easier access to credit and financial services for small and medium enterprises (SMEs) and individuals. Notably, such startups in Pakistan have approximately raised $55 million in funding in 2020, indicating growing investor confidence in the sector's potential.

Some recent examples of Pakistani fintech innovation include JazzCash and Keenu Wallet, which have revolutionized mobile banking and digital payments, particularly benefiting underserved populations in remote areas.

## Challenges

### *Data Protection and Cybersecurity*

There are certain factors hindering the full potential of fintech in Pakistan such as the absence of clear regulations around data privacy and security as evidenced by the delay in formalizing the Personal Data Protection Bill (PDPB) 2023[3]. This delay raises significant concerns regarding the safety and security of personal and financial information in the digital age, posing a substantial barrier to cultivating trust in digital financial services.

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[1] Zeidy, I. (2022) "The Role of Financial Technology (FINTECH) in Changing Financial Industry and Increasing Efficiency in the Economy".https://www.comesa.int/wp-content/uploads/2022/05/The-Role-of-Financial-Technology.pdf.

[2] "Payment Systems Review; For the 2nd Quarter of Fiscal Year 2023-2024", Digital Financial Services Group, State Bank of Pakistan https://www.sbp.org.pk/psd/pdf/PS-Review-Q2FY24.pdf accessed 21 June 2024

[3] Persona Data Protection Bill 2023

The PDPB aims to establish a legal framework for the protection of personal data in Pakistan. This is crucial for safeguarding individuals' privacy rights and fostering trust in digital services, including fintech. The establishment of the National Commission for Personal Data Protection, as proposed under the PDPB, could play a pivotal role as well. This commission would oversee the implementation of data protection laws, handle complaints, and ensure accountability among organizations handling personal data.

In the International law front, GDPR[4] (General Data Protection Regulation) sets stringent standards for protecting personal data, emphasizing consent, transparency, data minimization, and individuals' rights over their data. In this context there are some areas in PDPB that require improvement for better compliance. For instance, PDPB's Article 13 allows for broader interpretations of consent compared to GDPR Article 7, potentially leading to situations where consent is not freely given by the data subject. Moreover, PDPB lacks clarity on data transfer restrictions outlined in GDPR Chapter V, which may impede international fintech operations reliant on seamless cross-border data flows.

### *Digital Literacy*

Another significant challenge is the disparity in access. While fintech holds promise for advancing financial inclusion, disparities between urban and rural areas and across different socioeconomic levels limit the accessibility of these services. This is evident from the 45.7 percent internet users across the country[5]. The restricted reach hinders the ability of fintech companies to scale their services.

## Regulatory Framework

The State Bank of Pakistan (SBP) and the Securities and Exchange Commission of Pakistan (SECP) are the primary regulatory authorities governing the fintech sector in Pakistan. Notably, the SBP oversees the digital payments and consumer protection aspects, while the SECP focuses on the investment and securities-related elements of the fintech landscape. Additionally, the Payment Systems and Electronic Fund Transfers Act 2007 forms the

[4] Regulation (EU) 2016/679 (General Data Protection Regulation)
[5] Kemp S, “Digital 2024: Pakistan — DataReportal – Global Digital Insights” DataReportal – Global Digital Insights (February 23, 2024) <https://datareportal.com/reports/digital-2024-pakistan> accessed July 3, 2024

cornerstone of this regulatory framework, establishing the legal basis for electronic payment systems and ensuring user rights protection.

The SBP's Regulations for Electronic Money Institutions (EMIs)[6] are pivotal in creating a conducive environment for digital financial services. These regulations define the licensing requirements and regulatory standards for EMIs, aimed at safeguarding consumers, maintaining financial stability, and ensuring adherence to anti-money laundering and counter-terrorism financing standards. NADRA e-Sahulat[7], an electronic commerce platform, exemplifies how SBP-regulated EMIs are democratizing access to financial services in Pakistan, empowering citizens by providing them with convenient and secure avenues to manage their financial transactions effectively.

Furthermore, the SECP's Regulatory Sandbox framework[8] plays a crucial role by allowing fintech firms and financial institutions to experiment with innovations under regulatory supervision. Notably, the first cohort[9] of participants showcased notable success. Specifically, FINJA Lending Services Limited, with its peer-to-peer lending platform, and First Digital General Takaful, a dedicated digital takaful operator, achieved significant milestones. These pioneering tests not only validated their business models but also set a precedent for developing frameworks in mutual fund digital distribution and robo advisory services. Subsequently, SECP issued guidelines aimed at promoting the use of FinTech for distribution and advisory functions in the financial sector.

While both stakeholders acknowledge the need for regulations to protect consumers and maintain financial stability, their perspectives on the ideal approach differ significantly. Fintech startups often view the current regulatory framework as overly restrictive. Established financial institutions, on the other hand, prioritize risk management and consumer protection. They generally favor stricter regulations across the board, viewing them as safeguards against potential financial instability or predatory practices by unregulated fintech companies. Hence, finding the right balance between fostering innovation and ensuring consumer protection is key.

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[6] Regulations for Electronic Money Institutions 2023
[7] "E-Sahulat NADRA" <https://e-sahulat.nadra.gov.pk/> accessed July 2, 2024
[8] SECP Regulatory Sandbox Guidelines 2019
[9] "SECP Opens First Cohort under the Regulatory Sandbox" (SECP, January 21, 2020) <https://www.secp.gov.pk/media-center/press-releases/secp-opens-first-cohort-under-the-regulatory-sandbox/> accessed July 3, 2024

**Shortcomings in SECP and SBP's Framework**

Pakistan's SECP Regulatory Sandbox Framework for fintech holds promise, but improvements can unlock its full potential. Limited scope in the regulatory sandbox can stifle innovation in areas with high growth potential. Singapore's Monetary Authority (MAS) addresses this challenge with a tiered sandbox framework. This framework offers various levels tailored to different risk profiles and innovation types. Their FinTech Regulatory Sandbox 2.0[10] specifically allows experimentation in areas like digital identity, blockchain trade finance etc. This tiered structure provides a valuable blueprint for SECP.

Implementing a transparent exit strategy is imperative. It is essential to establish a clear and transparent process for exiting the sandbox and transitioning to full regulatory compliance. The Hong Kong Monetary Authority (HKMA) offers a well-defined exit strategy[11] for its Fintech Regulatory Sandbox. This notice outlines the specific regulatory requirements and licensing procedures they need to follow for full market launch. By adopting a Hong Kong-style exit strategy, Pakistan's SECP can provide a clear "Graduation Notice" outlining the licensing procedures and regulatory requirements for graduating companies for an easier transition.

In the context of SBP's EMI regulations, a tiered regulatory approach based on the size, complexity, and risk profile of the EMI could be beneficial. One-size-fits-all regulations for EMIs can stifle the growth of smaller FinTech companies in Pakistan. Malaysia's Securities Commission (SC) offers a potential solution with their tiered EMI regulatory framework. This system categorizes EMIs based on size and transaction volume, allowing for a risk-based approach. Smaller EMIs benefit from simpler regulations, while larger or more complex institutions face stricter oversight.

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[10] "Overview of Regulatory Sandbox" <https://www.mas.gov.sg/development/fintech/regulatory-sandbox> accessed July 5, 2024

[11] Authority HKM, "Hong Kong Monetary Authority - Fintech Supervisory Sandbox (FSS)" (Hong Kong Monetary Authority) <https://www.hkma.gov.hk/eng/key-functions/international-financial-centre/fintech/fintech-supervisory-sandbox-fss/> accessed July 5, 2024

**Recommendations:**

- Prioritise the enactment of Pakistan's Data Protection Bill (PDPB). The PDPB's consent requirements (Article 13) should be refined to ensure individuals freely give consent, mirroring the stricter standards outlined in GDPR Article 7 and it should clarify data protection restrictions as specified under GDPR Chapter V.
- Implement a tiered regulatory sandbox framework for fintech in Pakistan, similar to Singapore's MAS Fintech Regulatory Sandbox 2.0. This tiered approach can cater to various risk profiles and innovation types, fostering a more inclusive environment for financial innovation.
- The SECP should establish a transparent exit strategy for Pakistan's fintech sandbox, inspired by Hong Kong's model. A "Graduation Notice" outlining licensing procedures and regulatory requirements would ease the transition for graduating companies, fostering a more supportive environment for innovation.
- SBP should implement a tiered regulatory framework for EMIs similar to Malaysian SC's approach of categorizing EMIs based on size and complexity, fostering innovation for smaller players with simpler regulations while ensuring stability for larger institutions through stricter oversight.
- SECP and SBP can collaborate with the Pakistan Telecommunication Authority (PTA) and Ministry of Information Technology and Telecommunication (MoITT) to develop a multi-channel campaign to educate citizens about fintech benefits and responsible use.

| Action Matrix | | | | |
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| **Options for Pakistan** | | | | |
| **Option** | **Pathways to Solution** | **Implementation of Solution** | **Actors Responsible** | **Implementation Timelines** |
| **Prioritise Enacting the Data Protection Bill** | GDPR acts as the standard for protecting personal data, emphasizing consent, transparency, data minimization, and individuals' rights over their data. | PDPB's Article 13 should allow for broader interpretations of consent as illustrated in Article 7 of GDPR and clarify data protection restrictions as specified under GDPR Chapter V. | • Ministry of Law and Justice.<br>• Ministry of Information Technology and Telecommunication (MoITT)<br>• National Assembly of Pakistan. | 1-3 months for research and revision<br><br>3-6 months for Parliamentary approval |
| **Amending the SECP Regulatory Sandbox Framework to include a tiered approach.** | Singapore's Monetary Authority (MAS) uses a tiered sandbox framework which tailors to different risk profiles and innovation types. | By implementing a similar tiered sandbox with clear guidelines at each level, the SECP can foster a more inclusive environment for financial innovation. Lower tiers could focus on low-risk ventures, while higher tiers, with appropriate risk assessments. | • Securities and Exchange Commission of Pakistan (SECP).<br>• Ministry of Information Technology and Telecommunication (MoITT)<br>• State Bank of Pakistan (SBP) | 6-12 months for research and revision of the regulation |
| **Establish a transparent transitioning process in the SECP Sandbox Regulations** | A clear exit strategy from the Regulatory Sandbox with defined requirements and timelines empowers fintech startups for a smooth transition to full market compliance. The Hong Kong Monetary Authority (HKMA) offers such a well-defined exit strategy for its Fintech Regulatory Sandbox. | By adopting a Hong Kong-style exit strategy, Pakistan's SECP can provide a clear "Graduation Notice" outlining the licensing procedures and regulatory requirements for graduating companies for an easier transition. | • Securities and Exchange Commission of Pakistan (SECP).<br>• Ministry of Information Technology and Telecommunication (MoITT)<br>• State Bank of Pakistan (SBP) | 6-12 months to research and revise the regulations |
| **Introduce a tiered regulatory approach for EMIs** | A tiered regulatory approach such as Malaysia, categorizes EMIs based on size and transaction volume, allowing for a risk-based approach. Smaller EMIs benefit from simpler regulations, while larger or more complex | SBP should implement a tiered regulatory framework for EMIs similar to Malaysian SC's approach of categorizing EMIs based on size and complexity, fostering innovation for smaller players with simpler regulations while ensuring stability for larger | • Securities and Exchange Commission of Pakistan (SECP).<br>• Financial Monitoring Unit (FMU)<br>• State Bank of Pakistan (SBP) | 3-6 months to identify the categories<br><br>6-12 months to amend the regulations |

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| | institutions face stricter oversight. | institutions through stricter oversight. | | |
| **Promote Digital Literacy in Pakistan.** | By implementing a multi-channel, multi-lingual awareness campaign with a focus on consumer education and protection, Pakistan can foster a more informed and trusting environment for the growth and adoption of fintech solutions. | SECP and SBP can collaborate with the PTA) and MoITT to develop a multi-channel campaign to educate citizens about fintech benefits and responsible use.<br><br>Pre and post campaign assessments should also be conducted in order to assess the percentage increase in digital literacy. The target should be a 5 to 10 percent increase. | • Securities and Exchange Commission of Pakistan (SECP).<br>• Ministry of Information Technology and Telecommunication (MoITT)<br>• State Bank of Pakistan (SBP)<br>• Pakistan Telecommunication Authority (PTA) | 6-12 Months to initiate the campaign and to conduct pre and post assessments. |