Update on Regulation of Branchless Banking in Pakistan

February 2010

Note: This update of CGAP's 2007 "Notes on Regulation of Branchless Banking in Pakistan" incorporates research conducted by CGAP in February 2010 regarding relevant legal and policy changes through the end of 2009. It is one of 11 similar country updates produced by CGAP as a part of the work plan of the Access through Innovation Sub-Group of the G-20 Financial Inclusion Experts Group. However, CGAP alone is responsible for its content. Corrections may be forwarded to yseltzer@cgap.org.

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This update of CGAP's 2007 "Notes on Regulation of Branchless Banking in Pakistan"[1] incorporates research conducted by the Consultative Group to Assist the Poor (CGAP) in February 2010.[2] It is one of eleven country updates produced by CGAP as a part of the G20 Access Through Innovation (ATI) Sub-Group's workplan.[3]

1. Introduction

In an effort to promote the financial inclusion of the poor, the Government of Pakistan (GoP) has taken significant steps to create a legal and regulatory environment where "bank-led" branchless banking can thrive.[4] The State Bank of Pakistan (SBP), particularly its Banking Policy & Regulations Department, has spearheaded a thoughtful process that resulted in the issuance of the Branchless Banking Regulations dated March 31, 2008 (BBR). The BBR set out the ground rules for entry into and participation in the branchless banking market and greatly improve the possibility that financial services will be accessible on an affordable basis to millions of people who have been unbanked or underserved.

However, branchless banking that fosters financial inclusion of the poor has been somewhat slow to emerge due to several factors: banks must expend significant resources to develop the technology platform required; agents must be recruited, vetted and managed; new policies and procedures must be adopted. During the current period of economic uncertainty, some financial institutions have been reluctant to make this kind of new investment.

The SBP has urged commercial banks and microfinance banks to offer branchless banking, indicating that it would permit mobile network operators (MNOs) to operate on their own if the banks fail to act quickly.[5] In October 2009, Telenor Pakistan (Telenor), a

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[1] The 2007 "Notes on Regulation of Branchless Banking in Pakistan" was based on an analysis of existing legislation and regulations relevant to branchless banking approaches and on the CGAP research team's insights from interviews with a range of stakeholders. The original diagnostic assessment was carried out under the auspices of CGAP's Technology Program, which is co-funded by the Bill & Melinda Gates Foundation. The Pakistan diagnostic assessment was one of seven that provided evidence for CGAP & DFID's Focus Note 43, *Lyman, Timothy, Mark Pickens, and David Porteous. 2008. "Regulating Transformational Branchless Banking: Mobile Phones and Other Technology to Increase Access to Finance."* Washington, D.C.: CGAP & DFID, January."

[2] The research involved (i) a review of new regulations and other government documents as well as significant secondary sources and (ii) interviews with Ali Abbas Sikander, Group Executive Director, Tameer Micro Finance Bank Limited, and Navaid Kareem, General Manager, National Data Consultant (Pvt.) Limited**.**

[3] In September 2009, the G-20 called for the establishment of a Financial Inclusion Experts Group with two sub-groups, one of which is the ATI Sub-Group. CGAP is a member of an experts group assembled to assist the ATI Sub-Group in its work, which includes updating information previously published on the policy and regulatory framework for branchless banking in various developing countries.

[4] With bank-led branchless banking, the customer has a direct account relationship with the bank. Policy Paper on Regulatory Framework for Mobile Banking in Pakistan (Policy Paper), pp.2-3, at http://www.sbp.org.pk/bprd/2007/Policy_Paper_RF_Mobile_Banking_07-Jun-07.pdf. This is not the case with nonbank-led branchless banking.

[5] It is not clear whether the SBP would follow through with this plan given that a new regulatory scheme would have to be established to accommodate nonbank-led branchless banking. The SBP has expressed

major mobile telephone service provider and Tameer Micro Finance Bank (Tameer Bank), a microfinance bank majority-owned by Telenor, launched the EasyPaisa branchless banking platform. Other banks (United Bank Limited (UBL) and MCB) are also in the process of signing up agents, some of which are linked to MNOs and some of which are independent agents (e.g., retail chains), creating the potential for the banks to offer branchless banking services.

2. Sector Overview

2.1 Financial Inclusion

Although Pakistan's population exceeds 170 million,[6] there are only an estimated 16 million individual bank accounts,[7] leaving the vast majority of the population without access to banking services. Access challenges are particularly acute in rural areas, where there are fewer than 2,500 branches for a population of 105 million people—or an average of 42,000 inhabitants per branch.[8] In contrast, the number of mobile telephone customers exceeds 97 million.[9]

In its 2005-2010 Strategic Plan, the SBP identified the expansion of access to financial services to the poor as an important objective.[10] Since that time, the GoP has taken many concrete steps, including adoption of the BBR, to promote the goal of financial inclusion: MFIs have been encouraged through tax incentives to transform themselves into full-fledged banks, thus potentially expanding their size and outreach; the capacity of the Pakistan Poverty Alleviation Fund to provide credit enhancements to support pro-poor initiatives has been increased; commercial banks have been required to offer "basic banking accounts," with a minimum deposit of Rs 1000, no minimum balance and access to ATMs; the broadly-dispersed Pakistan Post Office network has been engaged to provide limited financial services; prudential regulations have been developed for specific sectors; and the SBP is promoting insurance products to support micro and

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caution about moving in that direction *See, e.g.*, Policy Paper, p. 10 ("…this model may be allowed at a later stage after we have sufficient experience in mitigating agent related risks using bank led model and need to think about mitigating only e-money related risks."). However, other regulatory agencies appear to be eager to participate in the regulatory process. *See, e.g.*, "SBP, PTA to introduce unified regulatory framework for engaging mobile banking in Pakistan," SBP press release, November 18, 2009 at http://www.sbp.org.pk/press/2009/PTA-Meeting-19-Nov-09.pdf (Nov. 18, 2009 Press Release)("...the Ministry of Information Technology issued Policy Directives to PTA [Pakistan Telecommunication Authority] to prepare a framework on technical implementation of BBRs.").

[6] Central Intelligence Agency, The World Fact Book, retrieved February 19, 2010, https://www.cia.gov/library/publications/the-world-factbook/geos/pk.html.

[7] **"**Overview, Financial Market Structure, Regulations, and Policies," p. 8, retrieved February 25, 2010, http://siteresources.worldbank.org/PAKISTANEXTN/Resources/293051-1241610364594/6097548-1242706658430/Ch1BringingFinancePakistanPoorMay192009.pdf; siteresources.worldbank.org/PAKISTANEXTN/Resource - 2009-05-19

[8] Pakistan 10 Year Strategy Paper for the Banking Sector (2010) (Banking Sector Strategy Paper), Section 55 at http://www.sbp.org.pk/bsd/10YearStrategyPaper.pdf.

[9] Pakistan Telecommunication Authority Website, http://www.pta.gov.pk/index.php?option=com_content&task=view&id=650&Itemid=603, retrieved February 19, 2010.

[10] State Bank of Pakistan Strategic Plan, 2005-2010, p.6, http://www.sbp.org.pk/about/Strategic_Plan_BOD.pdf, retrieved February 26, 2010. The primacy of this objective was repeated in the SBP's 2008 Annual Report as well as in the 2010 Banking Sector Strategy Paper. Banking Sector Strategy Paper, Section 46, p. 11.

small lending.[11]

In 2008, the UK Department for International Development committed £50 million to a Financial Inclusion Programme.[12] The focus for the first year was on lending to micro and small enterprises; for the subsequent four years, the plan is to concentrate on low-income housing finance and rural finance as well as on remittances and Islamic finance.[13]

The SBP continues to articulate ambitious financial inclusion goals. The GoP intends to have 15 million microfinance customers by 2015, to promote banking in rural areas, to increase small to medium enterprise and agricultural lending and to expand significantly the national coverage of bank branches and ATM outlets.[14]

2.2 Branchless Banking Regulations

After a well-attended workshop on branchless banking in November 2006, the GoP established a forum for relevant stakeholders to discuss Pakistan's approach to branchless banking. Over time, the participation of most of the major industry stakeholders declined, leaving the following as the main participants: the SBP, the Ministry of Information Technology (MoIT), and Tameer Bank.

In June 2007 the Banking Policy & Regulations Department (BPRD) of the SBP released its Policy Paper on Regulatory Framework for Mobile Banking in Pakistan (Policy Paper). As stated in the Policy Paper, bank-led branchless banking "offers a distinct alternative to conventional branch-based banking in that [the] customer conducts financial transactions at a whole range of retail agents (or through mobile phones) instead of at bank branches or through bank employees."[15] The resulting 2008 Branchless Banking Regulations generally implement the approach articulated in the Policy Paper.

The SBP considered several models of branchless banking before deciding to initially allow only bank-led models. The BBR permit three bank-led models: one-to-one, one-to-many and many-to-many. These three models apply to arrangements between banks and MNOs as well as to arrangements between banks and other agents (such as gas stations, chain stores, the Pakistan Post) using either mobile phones or other technologies such as point-of-sale (POS) devices to communicate between the bank and the agent. (The BBR refers to the non-MNO branchless banking arrangements as "alternate channels."[16]) In all cases, the customer has an account relationship with the bank through the establishment of a "branchless banking account" (BB account). The BBR define "branchless banking" to exclude "information services" provided by banks to their existing customers via channels including the phone, internet and SMS.[17] An

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[11] "Building Inclusive Financial System in Pakistan," speech by Dr. Shamshad Akhtar, Governor, State Bank of Pakistan, DfiD & HM Treasury Financial Inclusion Conference, London, UK, 19th June 2007, pp. 7-10; http://www.sbp.org.pk/about/speech/governors/dr.shamshad/2007/Draft-Agriculture-PRs-18-04-05.pdf, retrieved March 1, 2010.
[12] DfID Annual Report 2009. http://www.dfid.gov.uk/Documents/publications/PSA/E_Pakistan.pdf.
[13] http://www.sbp.org.pk/MFD/FIP/inclusion.htm.
[14] Banking Sector Strategy Paper, Sections 58, 66.
[15] Policy Paper, p. 2 at http://www.sbp.org.pk/bprd/2007/Policy_Paper_RF_Mobile_Banking_07-Jun-07.pdf.
[16] BBR, Section 3.1
[17] BBR, Section 2. The meaning of "information services" is not elaborated upon. However, given the statement in the Policy Paper (which pre-dates the BBR) that banks could offer existing customers the ability

example of the operation of such an arrangement is MCB Bank, which offers its customers the ability to engage in mobile phone-enabled internet banking via WAP[18] enabled smart phones. However, this model does little (if anything) to promote financial inclusion since there is no outreach to the unbanked, and it requires the use of expensive mobile phones.

The three models can be summarized as follows:

With the **"**one-to-one model," a bank offers banking services via a BB account through (*i*) a single MNO, either by means of an agency or a joint venture agreement with the MNO or (*ii*) an agent network.[19] The EasyPaisa Mobile Wallet (discussed below) offered by Tameer Bank and its parent, Telenor, to customers who have a Telenor mobile phone represents the one-to-one model. (Tameer Bank also offers a limited service through its EasyPaisa agents to the customers of other MNOs or customers that do not have a phone. These customers are able to transact one-off bill payments and send domestic remittances to other non-customers.)

The **"**one-to-many model" involves a bank offering banking services via a BB account: (*i*) to any person with a mobile phone provided that the customer's particular MNO can provide an SMS pipe with adequate speed for processing transactions; or (*ii*) through many independent agents.[20] As described in the BBR, in the case of mobile phone banking services, the model has limitations, including the fact that not all MNOs may be ready to offer the bank a priority SMS pipe to enable the bank to provide fast service. Second, the bank must bear all advertising and marketing expenses. Finally, the model may require the bank to rely upon its own branch network for product distribution and cash-in, cash-out services. United Bank Limited (UBL) appears to be preparing to use this model with its Orion product. On its website, UBL offers "Orion" customers (i.e., anyone with a mobile phone who registers with Orion via SMS and a phone call) the ability to send money via the mobile phone without restriction regarding the MNO involved. In addition, according to industry reports, UBL has started signing up independent agents (e.g., retail chains) as well as agents linked to MNOs and MCB will likely be taking a similar approach in the near future. Each agent will likely be equipped with a POS device that will enable customers to do cash in and cash out. Presumably, such customers will also be able to pay bills and make money transfers via such agents.

The **"**many-to-many model" involves a central transaction processing system (i.e., switch) that provides total inter-operability, allowing multiple banks to offer services to the customers of multiple agent networks or MNOs.[21] The switch must be controlled by a bank, an agent or subsidiary of a bank, or a subsidiary of a group of banks. The many-to-many model has not been implemented yet although the SBP views it as "the desired situation [in which] all banks and all telcos [are] able to entertain each other's

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to do account-to-account fund transfers and payments via SMS, it is reasonable to interpret "information services" to include instructions by a customer to make a payment from the customer's account. Policy Paper, p. 7.

[18] Wireless Application Protocol.

[19] BBR, Section 3.1.

[20] BBR, Section 3.1.

[21] The BBR analogizes the switch to the existing ATM network, which permits a customer of any bank to use the ATMs of any other bank. BBR, Section 3.1.

customers."[22] The many-to-many model presents certain benefits to banks, including: (*i)* the opportunity to purchase access to a switch (analogous to ATM access), which would reduce the required investment in the technology required to support MNO branchless banking, and (*ii)* access to a large pool of new customers and the fee income from providing branchless banking services to them.[23]

As the SBP exerts pressure to expand branchless banking services and banks look for ready-made solutions to meet their needs, third-party providers are exploring infrastructure solutions. Not surprisingly, early market entrants (notably Tameer Bank) are concerned that the many-to-many model (and, potentially, the regulatory changes that would favor it) would imperil the head start they have. In December 2009, the SBP and Pakistan Telecommunication Authority (PTA) agreed to set up a Joint Regulatory Committee to introduce a "unified regulatory framework for Third Party Solution Provider system."[24] It remains to be seen whether this new initiative will provide additional encouragement for the many-to-many model to be pursued and if so, by whom.

2.3 Major Market Players

There are five major MNOs in Pakistan (Mobilink, Telenor, U-fone, Warid and Zong) although consolidation in the market is expected. EasyPaisa, which is discussed in more detail below, provides unbanked Telenor customers with access to limited financial services offered by Tameer Bank, as described below. Other MNOs are facilitating the use of mobile phones as access channels to existing customers' bank accounts. For example, Mobilink (the largest MNO) and Citibank have plans to launch a mobile wallet in the next few months.

UBL has developed a mobile wallet product, Orion, that enables any customer of the five major MNOs who has registered as an Orion customer to transmit money to family and friends, buy prepaid mobile cards, and view and pay utility bills. UBL reportedly also currently has 250 direct agents registered and operating (primarily superstores, kirana shops, and medical stores) and more than 500 applications in the process. The aim is ultimately to have as many as 80,000 agents.

The Pakistan Post Office manages over 4 million savings accounts, mainly small accounts below Rs 10,000 (about USD 118), through more than 12,000 branches.[25] Currently, post offices are used as payment agents for the government and utilities, and they could also become agents for banks. The Pakistan Post has entered into partnership with Mobilink to provide a "mobile money order" for domestic remittances to Mobilink customers. Additionally, First MicroFinance Bank has renewed its alliance with the Pakistan Post to serve poor customers through post office sub-offices in rural areas.[26]

Pakistan has at least eight networks of agents that collate and pay bills for the major

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[22] *Id.*

[23] Of course, a switch would not take care of the need to establish and maintain the agent network that is an essential component of any of the bank-led models.

[24] Nov.18, 2009 Press Release, http://www.sbp.org.pk/press/2009/PTA-Meeting-19-Nov-09.pdf.

[25] Banking Sector Strategy Paper, Section 58(v) at http://www.sbp.org.pk/bsd/10YearStrategyPaper.pdf

[26] http://ismailimail.wordpress.com/2010/01/29/first-micro-finance-bank-ltd-and-pakistan-post-office-ink-sign-for-poverty-alleviation/

utility companies and fixed line telephone providers. The majority of these are privately run although the National Database and Registration Authority (NADRA)[27] also operates one network.

2.4 EasyPaisa, the First Large-Scale Branchless Banking Product

In October 2009, Tameer Bank[28] a microfinance bank, and its parent company, Telenor, a major MNO in Pakistan, launched EasyPaisa. EasyPaisa allows both Telenor and non-Telenor customers to make over-the-counter bill payments and money transfers through Tameer agents, who themselves hold accounts with Tameer.[29] In February 2010 the bank launched the EasyPaisa mobile wallet, which will allow them to offer savings, insurance, and loan services to Telenor customers. EasyPaisa is also accessible to Tameer's existing customers who have internet access.

As of mid-January 2009, Tameer had 4,500 EasyPaisa agents operational with 3,000 more identified. Tameer plans to have 12-15,000 EasyPaisa agents by the end of 2011 and 30,000 agents by 2012. In the four months since its launch, EasyPaisa had processed over 500,000 bill payments and person-to-person money transfers. Tameer Bank operates a call center staffed by 1200 employees, of whom 28 are bank employees dedicated to checking the account opening documentation provided by its agents in compliance with its "Know Your Customer" (KYC) policy.[30]

3. Current Legal Framework for Branchless Banking

The issuance of the BBR in March 2008 dramatically changed the branchless banking landscape in Pakistan. As defined in the regulations, branchless banking is the provision of banking activities by authorized financial institutions (i.e., commercial banks, Islamic banks and microfinance banks authorized under the regulations to engage in branchless banking) to customers having a BB account.[31] The regulations expressly restrict non-financial institutions from offering branchless banking services, stating that nonbank-led models will only be considered after "the players and stakeholders attain [the] necessary level of maturity and after putting in place necessary controls."[32]

Under the BBR, a customer can open one BB account (one account per customer per financial institution), and access a variety of services, including account-to-account fund transfers, person-to-person fund transfers, cash-in/cash-out, bill payments,

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[27] NADRA is responsible for registration and issuance of computerized national identity cards (CNIC). It claims that it has "registered 98 per cent of the male population and 71.2 per cent of the female population in the country."
See, NADRA Website:
http://www.nadra.gov.pk/index.php?option=com_content&view=article&id=169:nadra-launches-drive-for-100pc-registration&catid=14:latest-news, retrieved February 21, 2010.
[28] CGAP has provided grant funding to Tameer Bank to support the launch of EasyPaisa.
[29] During the first phase of the EasyPaisa roll-out, the ultimate customers will not have a direct banking relationship with Tameer; rather, they will conduct their transactions through accounts in the names of Tameer agents, who will be based primarily in Telenor service outlets.
[30] Tameer Bank has obtained an exemption from the biometric fingerprint scan requirement. See, BBR, Section 4.
[31] A BB account is defined in the BBR as an account maintained in a financial institution in which credits and debits may be effected by virtue of electronic fund transfers and which is used to conduct branchless banking activities. BBR, Section 2.
[32] BBR, Section 3.

merchant payments, loan disbursements/repayments, and remittances (subject to existing regulations).[33]

The BBR permit flexibility in the manner in which financial institutions and MNOs partner with each other. As described above, the BBR expressly contemplate several branchless banking models – "one-to one," "one-to-many," and "many-to-many" – which can involve a bank partnering with an MNO or other agents or a bank using other non-mobile phone technologies, in each case, to deliver banking services.[34]

Financial institutions must apply to and be approved by the SBP to offer branchless banking services.[35] Before applying, financial institutions are advised to prepare necessary policies and procedures, strengthen risk management and audit functions, and identify partners, service providers, and agents. A financial institution's application to offer branchless banking services must include certifications as to adequacy of risk management, security, and business continuity plans, and detailed documents and information about security systems. The SBP pre-screens applicants on the basis of overall financial condition and existing compliance measures (e.g., capital, solvency, liquidity, profitability, etc.). Based on this, the SBP grants an initial approval to enable the launch. Only after post-launch submission of additional documents and information (e.g., services offered, system schematic and transaction flows, software/hardware components, disaster/recovery plans, agent agreements, and confirmation of prior testing) does the SBP grant authorization.

The switch necessary for the operation of the many-to-many model must be capable of (*i*) settling all transactions on a real-time basis, (*ii*) storing all proofs of transactions, and (*iii*) providing a day-end statement of account to all members.[36] Furthermore, the switch must be owned by a bank, a subsidiary of a bank or group of banks, or an agent of a bank. [37]

There is some ambiguity as to the interplay between the BBR and other applicable regulations.[38] According to the BBR, the regulations "do not, in general, supersede or revoke any of the existing rules and regulations unless specifically stated. Further the scope of any such relaxation of rules and regulations will be limited to branchless banking only and shall not extend to cover any other banking activity."[39] Notwithstanding this provision, although the BBR expressly permit the use of agents for cash services outside of branches, there is no statement regarding the possible conflict with the Commercial Bank Regulations' implicit prohibition of the use of agents for cash-in transactions: "[b]anks shall not undertake any business of cash payments, other than the authorized place of business, except through the installation of Automatic Teller

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[33] BBR, Section 3.2.
[34] BBR, Section 3.1.
[35] BBR, Section 10.
[36] BBR, Section 3.1.
[37] *Id.* If the provider is an agent of a bank, then the agency arrangement is governed by the Guidelines on Outsourcing Arrangements, issued pursuant to BPRD Circular No. 9, dated July 13, 2007 (Outsourcing Guidelines), http://www.sbp.org.pk/bprd/2007/Annex_C9.pdf. BBR, Section 7.
[38] In addition to the Outsourcing Guidelines, other applicable regulations include the Banking Ordinance (1962), the Prudential Regulations for Corporate/Commercial Banking (updated on 31 January 2009) (Commercial Bank Regulations), The Prudential Regulations for Microfinance Banks, (MFB Regulations), and the Payment Systems and Electronic Fund Transfers Act, 2007 (EFT Act).
[39] BBR, Section 1.3.

Machines (ATMs). Banks desirous of providing the facility of withdrawal through Authorized Merchant Establishments at various Points of Sale (POS) may do so up to a maximum cash limit of RS 10,000."[40]

3.1 Use of Agents

When the Outsourcing Guidelines were issued in 2007, they became the primary source of guidance regarding the engagement of third-party service providers to perform certain "material activities," often relating to the bank's technological infrastructure.[41] The BBR add to this guidance in the context of branchless banking and expand the scope of permitted activities.

The BBR permit financial institutions to engage third-party agents to open Level 1 accounts,[42] provide cash-in/cash-out services,[43] offer bill payment services, and disburse and collect loans (although agents are not allowed to market or approve loans).[44] Agents may offer services on behalf of multiple banks, so long as the agent has a separate agreement with each bank, or banks may "organize their agent network using an open architecture" so that agents can handle other banks' customers using the infrastructure provided by only one bank.[45] Agents and banks must decide beforehand on any fees to be charged to customers, and such fees must be clearly communicated to customers. Agents cannot change these fees in any way without pre-agreement with banks.[46] Financial institutions bear liability for "acts of omission and commission of the Agent."[47] Potentially, this could include crimes under the Electronic Crimes Bill, 2006, which, if enacted, would criminalize a variety of electronic access, fraud, and misuse activities.[48]

The BBR contemplate agents of different types. "Super Agents" are well-established retail outlets or distributors (e.g., fuel distribution companies, Pakistan Post, courier companies, etc.) that contract with the bank and that are responsible for any "Sub Agents." "Direct Agents" contract with the financial institution and may include large to medium-sized stores.[49]

The BBR describe a variety of credit, liquidity, operational, legal, and reputational risks inherent in agent banking, and suggest risk mitigation measures.[50] First, financial institutions need clear policies and due diligence processes for selecting agents, including a list of minimum standards (e.g., well established, good

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[40] Commercial Bank Regulations, Regulation O-1. *See also*, Policy Paper, p.11, where this inconsistency is noted.

[41] Outsourcing Guidelines, Section 5.

[42] Level 1 accounts are subject to balance and transaction limits: the maximum balance is capped at Rs. 60,000, and the maximum throughputs are Rs 10,000 per day, Rs 20,000 per month, and Rs 120,000 per year. BBR, Section 4.

[43] As noted above, there is no explicit statement regarding the impact of the BBR on the contradictory provision in Commercial Bank Regulations, Regulation O-1, mentioned above.

[44] BBR, Section 6.1.

[45] *Id*.

[46] *Id.*

[47] BBR, Section 9.

[48] Electronic Crimes Bill, 2006. Section 25 on "Corporate Liability" specifies that "a corporation shall be held liable for a criminal offence punished under this Act committed on its instructions or for its benefit."

[49] BBR, Section 6.2.

[50] *See*, BBR Sections 6 and 8.

reputation, etc.).[51] Second, banks should ensure that a proper Anti-Money Laundering Combating the Financing of Terrorism (AML/CFT) monitoring process exists for branchless banking, and that responsibilities of agents are clearly communicated and monitored.[52] Third, financial institutions must have and submit to the SBP a signed agreement with each agent detailing, at minimum, roles/responsibilities, fee arrangements, and inspection and record-keeping obligations. The agent agreement must also specify suitable cash holding limits and require that transactions are accounted for and reflected in the bank's books by no later than the next working day.[53] Finally, financial institutions should ensure that any institutional risk management program covers the agent-related risks.[54]

3.2 AML/CFT

Section 4 of the BBR outlines a risk-based approach to customer due diligence. For Level 1 accounts, customers must fill out and sign an account-opening application form and provide a photocopy of his/her computerized national identity card (CNIC), verified by NADRA.[55] In addition, there must either be a face-to-face contact with a designated financial institution employee or a biometric fingerprint scan and a digital photo taken by the agent and sent to the financial institution. BB accounts that are Level 2 (top level and unrestricted) and Level 3 (designed for merchants, agents, businesses, banking agents, or third-party service providers) are subject to the full range of KYC and other prudential regulations applicable to all accounts.[56] The BBR also require that a bank's transaction processing system be capable of (*i*) enforcing the account level transaction limits, (*ii*) sending alerts to users close to limits, and (*iii*) analyzing transaction history, identifying abnormal/suspicious transactions and reporting them to the bank's compliance function.[57]

Under Regulations M1-M5 of the Commercial Bank Regulations, commercial and Islamic banks are required to collect additional information for their Level 2 and Level 3 branchless banking customers.[58] Furthermore, they must obtain accurate and meaningful originator information (including name, address, and account number) on funds transfers, including wire transfers, and the information should

[51] BBR, Section 6.3.
[52] BBR, Section 6.3.
[53] BBR, Section 6.4.
[54] BBR, Section 8.1.2.
[55] Since not all Pakistani adult citizens have a CNIC, this requirement is a barrier to access to branchless banking services.
[56] For example, Islamic and commercial banks are regulated by the Commercial Bank Regulations and microfinance banks are regulated by the MFB Regulations.
[57] BBR, Section 4.
[58] Under regulation M1 the prospective Level 2 or Level 3 customer must produce: (*i)* an attested photocopy of the CNIC or passport; (*ii)* if the CNIC does not contain a photograph, then an additional ID that contains a photo (e.g., driving license); (*iii)* if no other photo ID is available, then a copy of the photograph attested by the bank officer, a copy of the CNIC without photograph attested by the same person who attests the photo, and a written confirmation that the person has no other photo ID; (*iv)* in the case of a salaried person, an attested copy of his service card, or any other acceptable evidence of service (e.g., a certificate from the employer); (*v)* in the case of an illiterate person, then a passport size photo with right and left thumb print on the signature card. The CNIC must be verified through NADRA, which can be done online.

remain with the transfer through the payment chain.[59] Commercial and Islamic banks must also track and report all suspicious transactions.[60] Records of transactions and identification data must be kept for at least five years.[61]

Section 17 of the MFB Regulations also establishes a more relaxed "Know your Customer/ Customer Due Diligence" (KYC/CDD) process for certain clients of microfinance banks.[62] However, it is not clear how the requirements in the MFB Regulations relate to the KYC/CDD obligations in the BBR.

In November 2009, the President promulgated the "Ordinance to Provide for Prevention of Money Laundering" (AML Ordinance). The AML Ordinance establishes a Financial Monitoring Unit (FMU) to receive and analyze reports of suspicious transactions, assist in investigations, recommend changes to regulations, and generally exercise responsibility for AML.[63] The AML Ordinance also establishes a National Executive Committee to publish annual AML strategy, as well as take other high-level decisions and approvals with respect to FMU budgets and administration.[64]

The AML Ordinance covers "financial Institutions," defined as those that accept deposits, lend in whatever form, do money or value transfer, issue means of payment (including credit and debit cards, cheques, travellers cheques, money orders, bank drafts, and electronic money), and change money or currency, among others.[65] The AML Ordinance requires institutions to report any suspicious transactions and to keep records pertaining to these reports for a period of five years.[66] The AML Ordinance does not prescribe account opening/customer due diligence procedures, though the Federal Government and FMU have powers to make rules and regulations (and thus can accommodate the relaxation of the KYC/CDD requirements in the BBR).[67]

3.3 E-money

The Payment Systems and Electronic Fund Transfers Act, passed in 2007, defines electronic money[68] and provides that a range of institutions, not just banks, can apply to

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[59] Commercial Bank Regulations, Regulation M2.
[60] Commercial Bank Regulations, Regulation M5. A detailed list of factors that may make transactions suspicious or deserving higher scrutiny can be found in Annexures IX and X of the Commercial Bank Regulations.
[61] Commercial Bank Regulations, Regulation M3.
[62] "When considering proposals for extending Microfinance facilities, the MFB shall make all reasonable efforts to determine the true identity of its clients and shall develop and implement effective procedures and methods for the purpose. It shall inter alia obtain copies of National Identity Card or Passport or Driving license etc. of the client which shall be stamped as 'original seen' by the MFB officer. In far-flung and remote areas where people, particularly women, do not have identity cards, the MFB may extend micro-credit by establishing identity through other appropriate means." MFB Regulations, Section 17.
[63] AML Ordinance, Section 6.
[64] AML Ordinance, Section 5.
[65] AML Ordinance, Section 2.
[66] AML Ordinance, Section 7.
[67] AML Ordinance, Sections 44-45
[68] E-money "means money transferred through an Electronic Terminal, ATM, telephone instrument, computer, magnetic medium or any other electronic device…" Payment Systems and Electronic Fund Transfer Act (2007) (EFT Act), Section 2(s).

issue electronic money, thereby becoming "Electronic Money Institutions."[69] The BBR expressly provide that those regulations do not apply to e-money.[70] However, there are a number of provisions in the BBR that address the banking risks posed by wireless networks.[71]

3.4 Payment Systems

The SBP is given regulatory authority over the Payment Systems that process payment instruments and e-money.[72] The SBP can nominate clearing houses to provide clearing or settlement services for Payment Systems.[73] The SBP then supervises the clearing house as it discharges its settlement and other obligations with respect to the Payment Systems that it undertakes to service.

All ATM payments are covered under the EFT Act and its implementing circulars and rules.[74] There are two private ATM switches in Pakistan: M-Net, owned by MCB Bank and 1-Link, owned by eleven banks. All members of the ATM switches are banks, and both switches are interconnected.

3.5 Consumer Protection

Certain consumer protection issues with respect to branchless banking are now covered in the BBR.[75] The BBR require that a financial institution publish its schedule of charges on a quarterly basis (which can only be changed at these times) and disclose the charges at all its branches and agent locations and on its website. Banks are also held liable for "acts of omission and commission of the Agent," and such liability must be clearly indicated in customer agreements. The BBR highlight the importance of customer awareness as a defense against fraud, identity theft, and security breach, and suggest that a customer awareness program cover, at a minimum, the usage of branchless banking accounts, protection against fraud, and SIM/account blocking procedures in case a phone is lost or stolen.[76] Although banks are not required to send biannual account statements to Level 1 customers, they must be able to view their last ten transactions free of charge and obtain a printed account statement upon request, for a fee.[77]

Banks are required to devise clear guidelines for customer complaint and dispute resolution, and make these guidelines public.[78] The BBR suggest that complaint redress systems should (*i*) be capable of receiving a complaint through SMS, IVR, and email, and processing it within 24 hours, (*ii*) acknowledge a complaint and assign it a unique number, with an estimated resolution time, and (*iii*) keep track of all complaints and be able to provide a status report. The relevant contact

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[69] EFT Act, Section 24.
[70] BBR, Section 1.3.
[71] *See, e.g.*, BBR, Sections 8.2-8.3.
[72] EFT Act, Section 3.
[73] EFT Act, Section 18,
[74] *See, e.g.,* SBP Circular No. 2, August 22, 2009; http://www.sbp.org.pk/psd/2009/C2.htm
[75] BBR, Section 9.
[76] BBR, Section 9.2.
[77] BBR, Section 4.
[78] BBR, Section 9.1.

information for complaints (e.g., email, phone number) should be widely publicized and placed on the bank's website.[79] In addition to the consumer protection provisions in the BBR, other laws and regulations apply.[80]

Another potentially important change in the consumer protection regime relates to deposit insurance. When banks were nationalized in 1974, the GoP assumed responsibility for safeguarding customer deposits.[81] Because a number of banks have been re-privatized since that time, the SBP is looking to establish a deposit insurance system to replace the GoP guaranty. If deposit insurance replaces the government guaranty for most institutions,[82] depositors will have a more limited safety net.[83]

3.6 Minimum Technology Standards

For overall e-banking risk management, the BBR refer financial institutions to the "Risk Management Principles for Electronic Banking" (issued by the Basel Committee on Banking Supervision in July 2003) as a starting point for the development of e-banking risk management practices.[84] The BBR also include specific requirements with respect to data security, linked to the level of account. Level 1 accounts can use either SMS or USSD channels, and do not require message encryption. Level 2 and 3 accounts can use either WAP or SIM Application Toolkit (SAT) channels, and require 128 bit message encryption. For all accounts, the BBR require two-factor authentication (e.g., PIN and MSISDN in case of a mobile phone), secured records of all transactions stored by financial institution (for audit, investigation, and non-repudiation purposes), and infrastructure for a high availability of services in normal and disaster circumstances.[85]

3.7 Foreign Remittances - Pakistan Remittance Initiative

On August 22, 2009, the SBP issued Circular No. 2, announcing the Pakistan Remittance Initiative (PRI).[86] The intent of the PRI is to encourage the five major

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[79] BBR, Section 9.3.
[80] *See, e.g.,* BPD Circular No. 17 dated 23rd June, 2004 requiring banks to establish a Complaint Resolution Unit/Department. Banks are also required to devise a system for redress of complaints and to respond to complaints within ten working days. The Banking Ordinance (1962) also establishes an Office of Banking Mohtasib (ombudsman), to which a customer may turn if a complaint is not resolved to his/her satisfaction. The EFT Act, discussed above, establishes extensive disclosure and error resolution requirements. EFT Act, Sections 26-58; *See also*, BPD Circular No. 08 dated 24th July, 2006 requiring banks to provide deposit customers with periodic account statements..
[81] Banking Sector Strategy Paper, Section 133 at http://www.sbp.org.pk/bsd/10YearStrategyPaper.pdf; The Banks (Nationalization) Act, 1974 (XIX of 1974) and Notifications Issued Under the Banks (Nationalization) Act, 1974 (XIX of 1974)(as modified up to 7th June, 1997)(Bank Nationalization Act)
[82] In contrast to the Islamic banks and commercial banks, microfinance banks are now required to establish a depositors' protection fund. MFI Ordinance, section 19.
[83] The SBP advocates a coverage limit of Rs. 100,000 per depositor per bank, which would fully cover 77% of all eligible accounts in the banking sector in number but only 22% of the total value of deposits. Banking Sector Strategy Paper, Section 134 at http://www.sbp.org.pk/bsd/10YearStrategyPaper.pdf
[84] BBR, Section 8.2.2.
[85] BBR, Section 8.3.1.
[86] SBP Circular No. 2, August 22, 2009; http://www.sbp.org.pk/psd/2009/C2.htm, and SBP Circular No. 1, January 2, 2010, http://www.sbp.org.pk/psd/2010/C1.htm,

banks[87] to improve their services so that they will be more competitive with the unregulated hawala channels. Today, the hawala (which pose various regulatory issues, including AML/CFT-related risks) are responsible for handling approximately two-thirds of the funds transmitted from abroad. The PRI sets standards that require much quicker processing of remittances. A subsidy is provided to encourage the banks to implement these service improvements. In addition, customer information services to assist overseas Pakistani citizens locate convenient and legal channels to remit funds are being set up.[88]

[87] These banks - ABL, MCB Bank, HBL, UBL and NBP - have the correspondent banking channels necessary to handle foreign remittances. "Federal Government, State Bank launch historic Pakistan Remittance Initiative," SBP press release, August 22, 2009, at http://www.sbp.org.pk/press/2009/PRI-22-Aug-09.pdf.

[88] Pakistan Remittance Initiative Website, http://www.pri.gov.pk/