REGULATING MOBILE PAYMENT SERVICES IN PAKISTAN

Over the last few years, there have been growing efforts in Pakistan to increase the usage of digital and mobile payment services as an alternative to cash based transactions. While the more traditional "mobile banking services" - through which customers of a bank can access their bank accounts via their mobile devices - are being offered by various banks in Pakistan, increased attention is being paid to "mobile payment" services which can include the creation and issuance of new payment instruments in a mobile manner. Some prominent examples of such services are providers that offer issuance of virtual debit cards, and digital or e-wallets.

Digital wallets[1] in particular can position themselves almost as a functional alternative to a traditional basic bank account because (if the full suite of services are offered) they are not only able to reflect stored value for their users, but the users can also utilize the stored value to acquire goods or services. However, the existing regulatory regime in Pakistan is structured in a way that creates confusion amongst service providers as to which permissions /approvals / authorizations are required by each of the entities that are involved in the provision of these services.

In this article, we explore the basics of a digital wallet, introduce the current regulatory regime that is applicable to such product offerings, discuss some of the common structures, and some of the limitations of the regulatory regime that have acted as inhibitors to faster growth of the

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[1] The terms "digital wallet" and "e-wallet" are used interchangeably in this article. The terms are widely used for a whole variety of IT enabled financial services from vendor specific stored value credit, to closed loop cards, to branchless banking accounts.

mobile financial services industry.

Generally, digital wallets can be understood as electronic applications that are used to store a user's payment / loyalty card information on an electronic device such as a smartphone. These digital wallets then allow consumers to make electronic transactions such as making payments to merchants and/or transferring funds through the application to the wallets of other users.

Importantly, even though a digital wallet is packaged and presented as one application for a user, often there are multiple actors that combine to make such a wallet operational and effective. For example, one entity could provide the technological interface with the user, another could be the provider with whom the monetary account is residing, while a third could be the entity that processes the payment transactions. In the Pakistani context, there are already examples of private companies partnering with banks in order to enable consumers to create digital wallets that are linked with a bank account. For instance, FINCA Microfinance Bank Limited recently partnered with FINJA (Pvt.) Ltd. to launch a digital wallet known as SimSim. Anyone with a valid CNIC can create a SimSim account using their internet-enabled mobile phones.[2] Money can be added to this digital wallet through various methods such as debit/credit cards.[3]

Given that a digital wallet involves the maintenance of value, the utilization of that value for acquiring goods and services, a payment processing function where that value is reflected in currency, and a technological UI aspect, it is essential to understand what aspects of the regulatory regime applies to each function.

At its essence digital wallets in Pakistan are considered part of the larger mobile financial services industry and thus the main regulator is the State Bank of Pakistan. The key pieces of legislation are: (1) The Payment Systems and Electronic Fund Transfers Act, 2007 (**"PEFTA"**), (2) The Rules for Payment System Operators and Payment Service Providers issued by the SBP under PEFTA (the **"PSO/PSP Rules"**) and (3) the Branchless Banking Regulations issued by the SBP (the **"BB Regulations"**).

As per the aforesaid regulatory regime, entities involved in the provision of a digital wallet can fall in to one of the following categories: (1) a payment system operator/payment service provider (the **"PSO/PSP"**), (2) a bank licensed by the SBP, (3) a branchless banking agent and (4) an electronic money institution.

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[2] See: Quarterly Branchless Banking Newsletter, Jan-Mar 2017, Issue 23, State Bank of Pakistan, Page 11 http://www.sbp.org.pk/publications/acd/2017/BranchlessBanking-Jan-Mar-2017.pdf
[3] http://www.softwaries.com/2017/11/how-to-add-money-in-simsimpakistan.html

PEFTA and the PSO/PSP Rules regulate inter alia PSO/PSPs. Under the said laws a PSO/PSP is any entity that is engaged in providing payment systems related services like electronic payment gateway, point of sale gateway etc. – basically providing an electronic platform for clearing, processing, routing and switching of electronic transactions.[4] A "payment system" is defined as a system relating to payment instruments, or transfer, clearing, payment settlement, supervision, regulation or infrastructure thereof.[5] Whereas, a "payment instrument" is any instrument whether tangible or intangible that enables a person to obtain money, goods or services or otherwise make payment (but excludes notes, bills of exchange or cheques) .[6]

While much depends on the specific structure of each service (the end service can be structured in multiple ways at the back end) digital wallets that can be used to make payments to merchants will likely have at least some component that falls within the category of a payment instrument as defined in PEFTA. Further, the processing of payments from that payment instrument inevitably requires there to be a 'system' relating to the payment instrument in question i.e. a payment system.

Under PEFTA and the PSO/PSP Rules, a "payment system" can be operated only by a PSO/PSP.

Any company which operates (or wishes to operate) as a PSO/PSP must obtain approval from the State Bank by following the application procedure prescribed in the PSO/PSP Rules. In order to obtain such an approval, the PSO/PSP must *inter alia* be a company registered under the Companies Act, 2017 (previously the Companies Ordinance, 1984) and have a minimum paid-up capital of Rs. 200,000,000/-. A PSO/PSP also cannot act as a custodian of a consumer's money or perform any banking functions e.g. take deposits.

This does not mean that every digital wallet provider itself is a PSO/PSP. However, where the wallet provides the ability to purchase from merchants, the wallet provider would likely at least need to partner with a PSO/PSP that would process the payments made by users of that wallet service.

Up till now, the most common way in Pakistan of providing mobile financial services has been through the Branchless Banking Regulations, which allows companies to become "agents" of existing banks. Under the BB Regulations, banks (operating through agents instead of branches) can create a "branchless banking account" by using an agency or JV agreement with a non-bank entity. A "branchless banking account" is an account maintained by a consumer in a bank in which credits and debits may be effected by virtue of electronic fund transfers.

[4] Rules 2(p) and 6(1) of the PSO/PSP Rules
[5] Section 2(1)(zd) of PEFTA
[6] Section 2(1)(zc) of PEFTA

In this case, although the user never interacts with the bank directly (there are no branches) he/she is an account holder of the underlying bank. The account resides with, payment instruments are issued by, and also settled by the bank at the back end. The wallet provider - the entity that interacts with the user - is simply the agent of the bank and utilizes the regulatory approvals and payment infrastructure of the underlying bank.

A real life example of this structure is *SimSim* (mentioned above). According to information publicly made available about the platform, FINJA (Pvt.) Ltd. has not obtained any approval under PEFTA or the PSO/PSP Rules. Instead, it acts as a super-agent of FINCA Microfinance Bank Limited and has received authorization from the State Bank to do so under the BB Regulations. Thus, by collaborating with FINJA (Pvt.) Ltd., FINCA Microfinance Bank Limited has allowed its customers to have a branchless bank account in the form of a *SimSim* wallet. The balances shown on the *SimSim* wallet are only a reflection of the actual account balances of the customer residing with FINCA Microfinance Bank Limited. Importantly, since there is nonetheless an electronic fund transfer being effected through the SimSim wallet, a PSO/PSP has to be part of this product offering. In case of SimSim the electronic fund transfers are actually effected by 1-Link – a PSO/PSP.[7]

However, the growth of mobile payment services has highlighted some of the limitations of utilizing the BB Regulations for the provision of digital wallet type services to users. This is only natural because the BB Regulations govern "banking activities" only and are primarily aimed at offering flexibility to the financial institutions. One such obvious limitation of this structure is of course the fact that although the customer base is often developed by the wallet provider, the underlying customer relationship established is with the bank. Thus if the wallet provider wishes to change banks, the customers on that platform may not automatically migrate to the new bank.

Another issue with the existing regulatory regime is that digital wallets also have the potential of being included in the ambit of a third type of mobile financial service - that of "electronic money" as defined under PEFTA. PEFTA defines electronic money as *inter alia* an electronic store of monetary value on an electronic device that may be used for making payments. Further, under PEFTA an undertaking that issues means of payment in the form of electronic money is required to obtain a license from the State Bank. As yet, the State Bank has not issued any rules and regulations regarding the registration, procedures, requirements, and standards in order to be licensed as an electronic money institution. This adds to the uncertainty around the applicable regulatory regime.

In conclusion, it is clear that although there are many innovations in the financial technology sector that are being introduced in Pakistan, the regulations

[7] http://www.sbp.org.pk/PS/PSOSP.html

covering the mobile financial services market lack the requisite clarity to drive faster growth. To this end, allowing the new entrants to move away from a bank led, branchless banking model through the issuance of a detailed regime for electronic money institutions may go a long way in spurring further growth. Much of course will depend on the content of those regulations.