State Bank of Pakistan

بینک دولت پاکستان

Guidelines for Regulatory Sandbox

Digital Financial Services Group

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Abbreviations

AML: Anti Money Laundering

CFT: Combating the Financing of Terrorism

CPF: Countering Proliferation Financing

DFS: Digital Financial Services

EMI: Electronic Money Institution

Fintech: Financial Technology

KYC: Know Your Customer

LOA: Letter of Acceptance

MFB: Microfinance Bank

PS&EFT Act: Payment Systems and Electronic Fund Transfer Act, 2007

PSO: Payment System Operator

PSP: Payment Service Provider

RE: Regulated Entity

SBP: State Bank of Pakistan

SBP-BSC: State Bank of Pakistan, Banking Services Corporation

UBO: Ultimate Beneficial Owner

IFH: Innovation and Fintech Hub

Definitions

Applicant shall refer to a person/entity that intends to test its financial solution in the sandbox

Bank means a banking company as defined in Section 5 of the Banking Companies Ordinance, 1962.

EMI means the same as defined in Regulations for EMIs issued and revised by SBP from time to time.

Eligibility Criteria refers to the set of standards that SBP would use to assess the entities applying for sandbox.

Fintech refers to technologically enabled innovation in financial services that could result in new business models, applications, processes or products.

Participant shall refer to any person/entity that has been assessed as eligible by SBP to take part in the sandbox.

PSO/PSP means the same as defined in the Rules for PSOs & PSPs issued and revised by SBP from time to time.

RE means financial institutions licensed/ authorized and regulated by the SBP under any law administered by SBP, and includes Banks, Development Finance Institutions, Microfinance Banks, Exchange Companies; PSOs, PSPs, EMIs, and Third Party Payment Service Providers.

Regulatory Sandbox shall refer to a live testing environment for innovative products, services, business models or technology, pursuant to a specific testing plan, which includes some degree of regulatory lenience combined with certain safeguards.

Sandbox Committee refers to a committee, consisting of senior management of SBP and headed by Deputy Governor. It is responsible for making decisions on applications, testing and other important matters related to the sandbox.

Sandbox Lifecycle shall refer to the period of testing of a particular innovative product, service, business model or technology, starting from submission of application to exit from the sandbox.

SBP means the State Bank of Pakistan established under Section-3 of the State Bank of Pakistan Act, 1956.

Thematic Cohort shall refer to a regulatory sandbox implementation strategy wherein SBP may define the sandbox parameters and/or set the innovation theme of financial solutions or experimentations to be deployed in a particular sandbox lifecycle.

Innovation and Fintech Hub shall refer to the Innovation Office established by SBP to engage with industry players and stakeholders such as startups, individuals, Fintech firms, academia, etc. and act as an enabler and facilitator of Fintech activities in the domain of banking and Payments in Pakistan, and to handle the operations of Regulatory Sandbox.

1. Introduction

The recent developments in new technologies and fintechs have introduced innovative business models and solutions that have the potential to contribute to the public policy agenda of regulators such as digitalization and financial inclusion among others. Globally, many regulators are actively studying the potential impact of Fintech innovations on both consumers and the market, and adapting current regulatory frameworks to foster new opportunities without compromising consumer protection and financial stability.

One of the ways, devised by the regulators around the world, to achieve the aforementioned objective is development of a Regulatory Sandbox. A **Regulatory Sandbox** enables a live testing environment for innovative products, services or business models, pursuant to a specific testing plan, which usually includes some degree of regulatory lenience combined with certain safeguards. Regulatory Sandboxes have been adopted by many regulators for new entrants as well as established players who are looking for clarity around new digital solutions that do not easily fit into the existing regulatory framework.

In line with international best practices, SBP aims to foster innovation, facilitate experimentation and nurturing the growth of new financial technologies in a supervised setting by introducing Guidelines for Regulatory Sandbox. These Guidelines are being issued under the powers conferred by Section 3 of the PS&EFT Act. Hence, anything not mentioned in the Guidelines shall be covered by the PS&EFT Act.

2. Objectives of SBP's Regulatory Sandbox

The objectives of the Guidelines for Regulatory Sandbox are to:

a) Promote new technologies, products, and business models.
b) Identify the risks associated with innovative solutions and develop appropriate risk mitigation mechanisms.
c) Support evidence-based regulatory formulation.
d) Enhance regulatory clarity.
e) Coordination and collaboration with other regulatory sandboxes from domestic and other jurisdictions to work on areas of mutual interest.

3. Eligibility Criteria for Participation in Sandbox

3.1. Types of Eligible Applicants

SBP Regulatory Sandbox does not mandate an applicant to be deemed as SBP licensed entity. The application for participation in the sandbox will be open to all the applicants as defined in the following categories:

a) **SBP Regulated Entities** desirous of entering the sandbox in order to test a proposition can apply to the sandbox. After successful testing, entities may be given further approvals as per processes defined in relevant laws/regulations/rules.
b) **Entities Licensed by Other Regulators** in the country can also apply to participate in the sandbox. Such entities may include technology service providers, telecom companies,

payment system platforms, e-commerce platforms, third party service providers, Fintechs, etc. For such entities, access to the sandbox may be obtained through one of the following options:

I. Partnering with SBP licensed entity. In this scenario, the RE will be responsible for applying to SBP's sandbox.

II. The entity may directly apply to SBP through application process of the sandbox.

c) **Non-licensed Local Start Ups/Individual Applicants** with innovative Fintech solutions, having clear intent to get registered / authorized to market the solution/product/service after successful testing, may apply to participate in sandbox. Such entities may also partner with the entities regulated by SBP to apply for participation in sandbox.

d) **Entities Incorporated Outside Pakistan** can apply for the sandbox testing through either of the following options:

I. Partnering with an SBP licensed entity. In this scenario, the RE will be responsible for applying to SBP's sandbox.

II. Establishing an office in Pakistan and obtaining a certificate of incorporation by the relevant regulatory body of Pakistan.

3.2. Parameters for Eligibility of Applicants for Sandbox

The Applicants and their propositions would be evaluated based on the following parameters:

a) **Innovation:** The proposition must be based on innovative technology, product, service or business model and must differ from or add material value to existing solutions/products/services in the industry. At the time of application, the applicant shall describe the differentiating factor of its proposition compared to current market practices.

b) **Consumer Utility:** The proposition must aim to increase access or expand options to DFS in the country while also encouraging consumer utility compared to existing solutions. Consumer benefits can be, but not limited to, the following:

- Increased security.
- Increased accessibility (e.g. with focus to the disadvantaged groups).
- Enhanced consumer experience.
- Reduced onboarding time.
- Improved price benefit.

c) **Understanding of the Regulatory Barriers:** The applicant shall demonstrate that the proposition is currently not regulated or the regulations are unclear. To this end, the applicant is expected to have an in-depth understanding and analysis of existing laws, rules and regulations.

d) **Readiness for Testing:** The proposition shall be ready to be tested with real consumers, on limited scale.

e) **Scalability:** The applicant must have a plan to deploy the proposition on a commercial scale in Pakistan if the testing is successful.

f) **Risk Management:** The applicant must ensure that all significant risks arising from the proposition are assessed and mitigated through a risk mitigation plan. The applicant, at the time of application, must provide a risk matrix along with mitigation strategies.

Participation in the Sandbox shall not be allowed for:

I. Propositions that add no material value compared to similar solutions already deployed in Pakistan.
II. Similar product/solution already deployed in the market at commercial scale.
III. Testing where objectives of the Applicant are not clear or are not backed by its plans to achieve them.
IV. Applicants where beneficiaries or CEOs were previously found convicted of committing financial crimes or involved in ML/TF activities.
V. Applicants that are in the process of bankruptcy or found insolvent.
VI. Products and services that are prohibited by law of the land and SBP.
VII. Products and services which, if implemented, will be in breach of the international obligations.

4. Sandbox Cohorts

The participation in Regulatory Sandbox shall be based on a cohort system wherein entities will be allowed to enter the sandbox simultaneously and given the same time span for testing. SBP will be announcing Regulatory Sandbox cohorts on its website and other channels, such as social media, print or electronic media, from time to time, indicating the following:

a) Theme of Cohort.
b) Deadline for submitting formal applications.

5. Preliminary Assessment by the Innovation and Fintech Hub

Innovation and Fintech Hub shall facilitate and assist the applicants to formally apply for participation in Regulatory Sandbox. At minimum, an applicant must provide the following information to the relevant personnel of the Innovation and Fintech Hub.

a) Brief description of the business proposition.
b) Description of how it can contribute to the market development.
c) Information about the applicant entity including its sponsors and senior management

The Innovation and Fintech Hub will review the profile of the potential applicant and its proposition and gauges it against the eligibility criteria for participation in sandbox. During preliminary review, Innovation and Fintech Hub may request additional information from the applicant and/or organize meetings with the applicant for providing any necessary assistance.

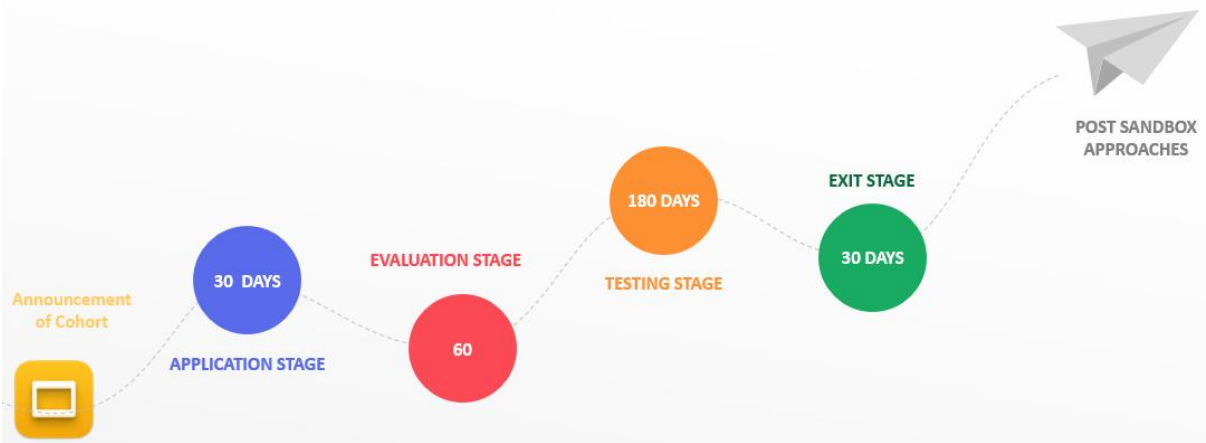
Based on the preliminary review, Innovation and Fintech Hub, may:

a) Advise the applicant to submit formal application for evaluation purpose.
a) Identify deficiencies and what is needed to be addressed in the application to make it ready for submission.
b) Inform the applicant that its proposition cannot be accepted along with reason for non-acceptance.

Opinion/feedback of the Innovation and Fintech Hub during preliminary assessments will not be a binding on potential applicant or SBP.

6. Sandbox Lifecycle

The sandbox lifecycle is made up of four stages which are triggered sequentially and conclude at the Exit stage.



6.1. Application Stage

At the application stage for Regulatory Sandbox cohort, the applicant submits the formal Application to SBP as per these Guidelines. The formal application shall be submitted on email ID regulatory.sandbox@sbp.org.pk addressed to "The Director, Payment Systems Policy & Oversight Department, State Bank of Pakistan, 4th Floor, Main Building, I.I Chundrigar Road, Karachi - 74000".

The formal application shall include the following:

a) Cover letter stating the interest in testing of their proposition in the sandbox signed by the CEO.
b) Description of the proposition and information about the applicant and ultimate beneficial owner (UBO) as per Annexure-A.
c) Detailed Testing Plan
d) Incorporation documents
e) Copy of license (if applicable).
f) Proof of submission of Application processing fee
g) Request for relaxation in regulatory requirements (if any)

In case of joint applications (e.g. when a foreign entity partner with SBP regulated entity), incorporation documents and licenses shall be provided for each participating entity. Documents that are issued in foreign languages, other than English, shall be properly translated

in English. Innovation and Fintech Hub will review the submitted documents. In addition to the above mentioned requirements, SBP may request additional information/documents from the applicant to aid in its evaluation of the application. The applicant at its own discretion may also submit additional information/documents that it deems necessary for the evaluation of its application by the SBP.

6.2. Evaluation Stage

The initial evaluation will be conducted by the Innovation and Fintech Hub. It would assess the documents of the applicant for completeness, correctness and suitability based on the parameters defined in Section 3 of the document.

Based on the initial review of the Innovation and Fintech Hub, the Sandbox Committee would review and assess the application to reach to a decision. If necessary, the Sandbox Committee may advise Innovation and Fintech Hub to arrange meetings with the applicant and/or seek additional information.

Following the Evaluation Stage, the Sandbox Committee may decide either to approve or reject the application. All applicants would be timely informed of the decision of the Sandbox Committee. Eligible applicants would be informed of the subsequent steps towards experimentation. The testing plan would be considered invalid if the applicant is unable to initiate the testing by the start date as per the plan or fails to sign the testing plan. Details of sandbox participants, entity name, brand name, proposed product/solution/service to be tested and any other details which is deemed necessary for public good, shall be made public by the SBP through its website and social media.

6.3. Testing Stage

During the testing stage, the sandbox participants shall provide the services to the real users according to the terms of the testing plan. During the testing stage, the sandbox participants shall submit periodic reports as required by SBP and as agreed under the testing plan.
The purpose of the testing stage is to evaluate the proposition of the applicant, subject to the parameters of the testing, as agreed with SBP. Throughout the testing, the sandbox participant will be able to assess the viability of the proposition, operational effectiveness, associated risks, and the efficacy of the risk mitigation measures.
The sandbox participant shall submit the report on the results of the testing, no later than two weeks after the scheduled end of the testing that includes, at least, the following:

a) Whether the Key performance indicators (KPIs) have been achieved. If not, then stating the reasons for not achieving KPIs.
b) Whether the product or service will be deployed on full scale.
c) Risks identified during the testing period.
d) SBP's supervision team may make an onsite visit at any time during testing or at the end of testing on need basis.

SBP has a right to terminate the testing if the testing plan is breached or any unanticipated risks arise during the test. If the testing ends prematurely, the sandbox participant shall execute the exit strategy.

6.4. Exit Stage

At the Exit Stage, the decision on whether to allow deployment of the service at full scale or to discontinue provision of the service shall be made by the Sandbox Committee and/or the sandbox participant. This decision will depend on factors that include adherence to the testing plan, results of the KPIs, and relevant risks and mitigation plan. In principle, if the KPIs are not achieved, the testing would be considered unsuccessful.

If the testing is not successful as decided by the sandbox Committee or the sandbox participant is not willing to roll-out product or service, it shall execute the exit strategy. Otherwise, the rollout of the product or service will be subject to No Objection Letter (NOL), and change in existing regulation or issuance of new regulations. If further deployment of the service is dependent on the regulatory changes, the participants may be allowed by the Sandbox Committee to continue provision of the service subject to prescribed terms and conditions, until the regulatory changes are adopted.

7. Post Sandbox Approaches

After completion testing period, the following approaches may be adopted:

a) Licensing (or Equivalent): In case of successful testing results, the entity may apply for license, under relevant regulations, to operate commercially, after fulfillment of necessary regulatory requirements. If there is no enabling framework in place immediately, the entity may be issued with a No Objection Letter (NOL) by SBP to operate until an enabling framework is developed. The validity period for such approval if granted, may be determined and communicated on case-by-case basis.

b) Reapplication to Sandbox: If test results indicate that the innovation has potential, but same was not adequately proven during the time frame of the sandbox participation, the entity could be invited to reapply for participation in a next round of sandbox applications.

c) Restriction for Commercial Operations: If a full assessment indicates that the participant has not fulfilled the terms and conditions of its sandbox test or that the innovation is unfit for the market, the participant shall be advised to discontinue its activities.

d) Policy Developments: If the outcomes of the tests indicate that further regulatory changes are required to fully realize the technologies and services that have successfully navigated a sandbox test, SBP may initiate work on revisions in the relevant regulations or developing new regulations, if necessary.

8. Obligations of Sandbox Participants

8.1. Reporting Requirements

Following are the reporting requirements for the participants:

a) The sandbox participant must submit information and progress reports to SBP as per agreed format and timelines during the testing stage. The SBP shall have complete access to core reporting/accounting/significant software that the company may be using, if required. Alternately, the reports shall be signed and submitted by competent authority designated by CEO through email.
b) The participant shall also maintain proper records during testing period for reviews by SBP anytime, if required. Retention and confidentiality of consumer data should be complied as per Section 70 of the PS&EFT Act.

8.2. Risk Mitigation Measures

To mitigate potential risks associated with the testing of the proposition, SBP may put some risk mitigation requirements on testing, such as:

a) Limit the number of clients at any point in time.
b) Restrict value and volume of transactions (total, per day, per week, etc.).
c) Limit the scope of regions where the services are offered.
d) Limit the outstanding liabilities at any point of time for the sandbox participant.
e) Restrict the types of transactions that can be performed.
f) Other risk mitigation measures that Sandbox Committee finds appropriate.

It will be mandatory for the participant to ensure compliance with the risk mitigation measures as advised by SBP.

8.3. Changes During the Testing Phase

In case of changes during the testing phase:

e) The sandbox participant shall notify SBP of any material changes to the information that was previously submitted to SBP within the sandbox lifecycle. For the purpose of these Guidelines, material changes will include any changes that affect the nature of the proposition, associated risks, ownership structure of the applicant and/or co-applicant.
f) The sandbox participant may request a change to the testing plan, by submitting a formal letter to Sandbox Committee, stating the reasons for such change, no later than 30 days before the scheduled end of the testing. Sandbox Committee shall review the request to change the testing plan. Changes to the testing plan should not lead to any unmitigated risks and/or changes to the nature of the proposition.
g) The sandbox participant may request for extension of testing period. To request extension, the participant shall submit written application to SBP no later than 30 days prior to the expiry of testing period. SBP will grant extension only in cases where the proposition has tested positively and extension in the period will further help in solving any specific problem, issues or risks.
h) Decision on the change to the testing plan shall be communicated to the sandbox participant by the Sandbox Committee no later than 15 days after the submission of the request.

8.4. Consumer Protection and Dispute Resolution Mechanism

The sandbox participants must adopt measures to protect the rights and interests of consumers in implementing sandbox proposition to ensure that customers are well-informed and protected in availing the product or service being tested, including safeguarding of the privacy and confidentiality of their data. Customers shall be clearly informed that the product or service being offered is a part of sandbox testing. Moreover, customers shall be informed of all the possible risks associated with the product.

Customers shall also be informed of the related complaints handling and dispute resolution procedures. Participants shall ensure that adequate, prompt and effective mechanisms and procedures for handling and resolving disputes, covering regulatory sandbox issues, are in place. SBP at any stage shall not bear any liability (including legal liability) arising from sandbox testing process and any such liability will be borne by the participant. In this respect, it is advised that under Section 71 of the PS&EFT Act, in case a consumer is not satisfied with the outcome of a complaint, he/she can lodge a complaint to SBP and/or Banking Mohtasib.

8.5. Additional Information

SBP may request additional information from the applicants or sandbox participants. While requesting additional information, SBP will set the deadline for providing it. Failure to provide requisite information may result in termination of the participant.

9. Application Fee

a) An application-processing fee will be charged that would be specified at the time of announcement of Regulatory Sandbox cohorts.
b) The application fee shall be deposited in SBP-BSC offices.

10. Revocation of Approval or Early Exit from the Sandbox

In addition to the scheduled exit, the testing stage may end for one of the following reasons:

a) **Early Exit:** The testing may be terminated before the prescribed time, on sandbox participant's request. In this case, the sandbox participant shall formally inform SBP about the decision to terminate the testing. After the SBP's approval, the participant shall implement the exit strategy, as per the testing plan.
b) **Mandatory Exit:** The testing may be terminated by the decision of the Sandbox Committee (revocation of approval). Such decision may be taken in case of the breach of the testing plan, or if the deployment is expected to have negative consequences for the consumers and/or overall financial stability or failure by the participant to provide requested information. In this case, the Sandbox Committee formally informs the sandbox participant about the decision and the date from which the exit strategy shall be implemented. Prior to revocation of approval, Sandbox Committee may request clarifications from the sandbox participant on steps taken to mitigate the risks and comply with the testing plan.

All decisions regarding the revocation of approval for testing shall be final and irrevocable.

11. Re-application

In case the application was rejected, applicants may re-apply in the next cohort for Regulatory Sandbox, provided that the deficiencies are properly addressed or substantial changes are made to the application.

The sandbox participant, facing an early exit from the sandbox, will remain eligible to apply to the next application cohort if the risks and deficiencies, highlighted during previous sandbox testing are appropriately addressed and the sandbox participant was not banned to apply in future.

Applicants may not re-apply if:

a) The proposition is associated with high ML/TF risks, economic risks or consumer protection risks which are not properly mitigated or cannot be mitigated.
b) The applicant and/or co-applicant are not eligible for sandbox as per the Guidelines.
c) The same proposition has already been tested by the applicant in the sandbox.
d) The proposition does not fit in to the new cohort.

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Annexure A – Application form for the SBP Sandbox

This application shall be filled by the applicant. Elements that are not applicable to the proposition may not be filled. SBP reserves the right to request additional information from the applicant, if required.

Applicant Details	
Information about the entity	
1. Name of the company	
2. Trade name	
3. Business registration number (e.g. Tax identification number) and the country of incorporation	
4. Information of relevant license(s) or authorization(s) (if applicable)	
5. Country or countries in which the company operates	
Information about the management/Sponsors/Shareholders	
1. Name of key personnel (e.g. CEO, CFO, COO)	
2. Shareholders, Sponsors, Ultimate Beneficial Owner (UBOs)	
3. Undertaking for non-involvement in illegal activities or in process of bankruptcy/insolvency, of individuals mentioned in point 1 and 2	
4. Name of subsidiaries, parent company, holding company etc.	
Contact details	
1. Postal address	
2. Name and contact details of key contact person for liaison purposes (phone, email)	
3. Website	
Information about the partner[1] (if applicable)	
1. Name of institution(s)	
2. Business registration number (e.g. Tax identification number) and the country of incorporation.	
3. Information of relevant license(s) or authorization(s) (if applicable)	

[1] Filled out in case of joint applications on behalf of the two or more entities.

4. Postal address.	
5. Name and contact details of key contact person for liaison purposes (phone, email).	
6. Details of the partner agreement with the applicant (distribution of responsibilities, functions, obligations, etc.).	
7. Describe experience and relevant technical and business knowledge of partner organization that will support implementation of the product (e.g. background of the senior management, size of the team).	
Information about the proposition	
1. Brief description of the proposition	
2. Explain how the proposition relates to the topic of the cohort, as prescribed by SBP.	
3. Explain how the proposition may bring additional utility to the consumers	
4. Explain how the proposition is different from other similar products or services in the market	
5. Describe regulatory barriers that prevent the full-scale implementation of the proposition	
6. Are there any similar products deployed in other jurisdictions? (if yes, please, provide details). Has the innovative financial service proposed been tested in other country sandbox and/or evaluated by the regulatory authorities of other jurisdictions?	
7. When the proposition might be provided to the real consumers, if approved for the testing?	
8. Resources including how liabilities/expenses will be met out?	

9. Describe your plans for the subsequent scaling of the proposition if the testing is successful.	
Proposals for the testing phase	
1. Describe the objectives of the proposed test	
2. Describe the risks associated with the sandbox testing and identify appropriate risk mitigation measures/safeguards	
3. Describe regulatory exemptions that are required for the testing purposes.	
4. Describe restrictions that might be used during the testing for risk mitigation purposes (e.g. on number of clients, volume and number of transactions and other).	
5. State the expected duration of the testing	
6. Describe the expected milestones and their timelines	
7. What are the key performance indicators that you propose to use to assess the success of the testing?	
8. Provide any other information that may support the application.	
9. Describe the exit strategy for the regulatory testing (steps to wind down operations)	