SECP

SECURITIES AND EXCHANGE
COMMISSION OF PAKISTAN

Navigating Innovation:

A Journey Through the Regulatory Sandbox

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Foreword Chairman

The financial landscape is evolving at an unprecedented pace, driven by rapid technological advancements and innovative business models. As the Chairman of the Securities and Exchange Commission of Pakistan (SECP), I am pleased to introduce the journey of Regulatory Sandbox, an initiative that embodies our commitment to fostering innovation while ensuring robust regulatory oversight.

The Regulatory Sandbox strikes a balance between fostering financial innovation and ensuring consumer protection and market integrity. It offers a controlled environment where innovators can test financial products, services, and business models with real customers under tailored regulations. This is a valuable opportunity for both start-ups and established financial institutions to experiment, learn, and scale their solutions in a risk-mitigated setting.

Pakistan's financial sector is on the verge of digital transformation, driven by advancements in fintech, insurtech, and regtech. The Regulatory Sandbox reflects the SECP's commitment to support innovation and creating an ecosystem where new ideas can thrive.

The sandbox is crucial for addressing regulatory uncertainties and cultivating a culture of innovation. It provides a framework for experimentation and iterative learning, allowing us to identify and address potential regulatory barriers early. This proactive approach refines regulatory frameworks and balances innovation with consumer protection and financial stability. The iterative feedback loop ensures that businesses, consumers, and regulators all benefit from the insights gained during testing.

The Regulatory Sandbox encourages open dialogue between the SECP, innovators, market participants and fosters collaboration by offering regulatory flexibility. It helps in better understanding of emerging technologies and identify regulatory challenges. Thus, gearing SECP to develop frameworks that support innovation while protecting public interest.

I extend my heartfelt appreciation to all those who have contributed to the Regulatory Sandbox and look forward to witnessing the ground-breaking innovations that will emerge from this platform. Together, we can harness the power of innovation to drive economic growth, enhance financial inclusion, and build a secure and prosperous future for our nation.

Executive Summary

The SECP Regulatory Sandbox (RSB) has facilitated the testing of financial products and services by both startups and established firms, significantly enhance market efficiency and expanding financial inclusion to underserved populations. Over four successful cohorts, the RSB has provided a controlled environment for innovation, enabling participants to trial diverse and pioneering business models aimed at improving consumer convenience.

Amidst the challenges impacting fintechs, RSB provides an anchor from the uncertainties be it business risks or the regulatory response to their innovation. It has supported innovators in identifying risks, evaluating market potential, and navigating regulatory hurdles, thereby fostering confidence among investors and entrepreneurs. This approach has been essential in sustaining fintech growth and ensuring the effective scaling of innovative solutions in Pakistan's evolving financial landscape.

The cohort-based performance of the SECP Regulatory Sandbox has been marked by the successful testing of a diverse range of innovative financial solutions with significant market impact. Notably, platforms for peer-to-peer (P2P) lending, digital and parametric insurance, digital asset management services, digital mutual fund distribution, digital brokers, and algorithmic trading have all demonstrated substantial potential. These innovations have showcased their impact in terms of enhanced market efficiency, deepening financial inclusion, and accessible financial services. Each of these tested solutions not only addresses current market needs but also sets the stage for transformative changes in Pakistan's financial landscape, promising to deliver greater convenience and improved financial management for a wide array of users.

Looking forward, the SECP has transitioned the RSB from a cohort-based model to an "always open" status, offering continuous access for innovators to test their solutions. This shift allows for greater flexibility and inclusivity, accommodating a wider range of financial models, including Conventional, Islamic, and Women-Led enterprises. The future of the RSB will see greater liaison with SECP Innovation Office to create synergies, enhanced support to participants and introduction of mentorship programs, to strengthen the sandbox’s role in fostering financial innovation. This forward-looking approach is set to further elevate Pakistan's financial ecosystem by ensuring ongoing support for emerging technologies and innovative business models.

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1. Background

Sandboxes are not limited to children's play but are valuable tools for organizations as well. Globally, these sandboxes provide a controlled environment where businesses can safely test new innovations and technologies, particularly within the fintech sector. The primary objective is to foster innovation in a secure and responsible manner. This can include testing new products, services, solutions, technologies, business models, and even policies.

In such environments, regulations are often relaxed or adapted to create a more favourable setting for experimentation. As these innovations have the potential to reshape industry landscapes, regulatory sandboxes also enable regulatory bodies to evolve their frameworks and keep pace with these developments, ensuring market integrity and the continued protection of consumers.

(a) Evolution of the Sandboxes: World View

The sandbox concept was born in the IT industry, for developers to safely experiment with suspicious code, launch simulated attacks, or assess security software vulnerabilities. As technological disruption in Financial sector gained momentum, financial sector regulators worldwide adopted regulatory sandboxes allowing fintechs to conduct timebound live experiments with new technologies enabling them to deliver innovative financial products and services. The first regulatory sandbox was envisaged in November 2015 and launched in 2016 by the United Kingdom's Financial Conduct Authority. Since then, over fifty central banks have implemented the concept in their jurisdictions.

Table 1: Global Insight of Regulatory Sandbox

Country	Regulatory Sandbox	Year of Initiative
United Kingdom	Financial Conduct Authority (FCA) Sandbox	2016
Australia	Australian Securities and Investments Commission (ASIC) Sandbox	2016
Singapore	Monetary Authority of Singapore (MAS) FinTech Regulatory Sandbox	2016
Hong Kong	Hong Kong Monetary Authority (HKMA) Fintech Supervisory Sandbox	2016
Malaysia	Securities Commission Malaysia (SC) Fintech Regulatory Sandbox	2016
Canada	Canadian Securities Administrators (CSA) Sandbox	2017
United Arab Emirates	Abu Dhabi Global Market (ADGM) Regulatory Laboratory	2017
Saudi Arabia	Saudi Arabian Monetary Agency Sandbox	2017

India	Reserve Bank of India (RBI) Sandbox	2019
Pakistan	Securities and Exchange Commission of Pakistan (SECP) Sandbox	2019
Brazil	Brazilian Securities Commission (CVM) Sandbox	2020
South Africa	Financial Sector Conduct Authority (FSCA) Sandbox	2020
Switzerland	Swiss Financial Market Supervisory Authority (FINMA) Sandbox	2021
Kenya	Capital Markets Authority (CMA) Sandbox	2022

Source: Bank for International Settlements

(b) Catalyst for Change: Why Regulatory Sandbox Matters?

The need for regulatory sandbox arises when the pace of market disruption, due to rapidly evolving landscape of technology and innovation, outpaces the change in traditional regulatory frameworks. The regulatory sandbox matters because it provides a safe, controlled environment for testing innovative financial solutions, enabling regulators to address emerging challenges while mitigating risk and protecting consumers. This approach not only supports the safe development and deployment of new technologies but also allows regulators to adapt and update their frameworks in response to emerging trends.

Encourage Innovation

By offering a controlled space for experimentation, regulatory sandboxes lower the barriers to entry for new start-ups and encourage the development of novel solutions. This leads to a more dynamic market, as businesses can pilot innovations without the full burden of regulatory compliance, allowing them to fine-tune their offerings based on real-world feedback.

Improve Regulatory Frameworks

Sandboxes allow regulators to observe the impacts of new technologies firsthand. This real-time data and insights, enable more informed decision-making and the development of regulations that better address the nuances of innovative technologies. This iterative process helps create a more adaptable and forward-thinking regulatory environment.

Enhance Consumer Protection

While sandboxes promote innovation, they also emphasize consumer protection. Participants are directed to adhere to certain safeguards to ensure that consumers are not exposed to significant risks. This balance ensures that while innovation is encouraged, it does not come at the expense of consumer safety and rights.

Foster Collaboration

Regulatory sandboxes facilitate collaboration between innovators, regulators, and other stakeholders. This collaborative approach helps identify potential regulatory obstacles early on and find mutually beneficial solutions. Such partnerships are crucial for creating a regulatory environment that supports sustainable innovation while maintaining market integrity.

The design of a regulatory sandbox determines the range of verticals and aspects of a fintech innovation that could be tested. This may include the product's structure, the appropriateness of the technology, or the use of technology to facilitate regulatory compliance. Figure 1 below illustrates the various verticals that have been tested through regulatory sandboxes globally in the post-COVID period, highlighting the areas of focus and innovation that have emerged.

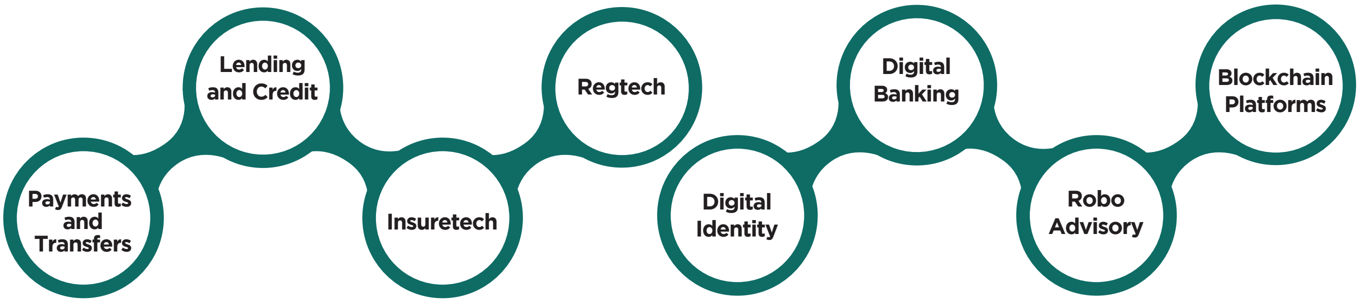


Figure 1: Post-Covid Focused Areas

2. Sandbox or Quicksand? An Analysis of SECP Regulatory Sandbox

The concept note on regulatory sandbox benchmarked on the global practices kick started the RSB journey at SECP. The concept note translated into guidelines that defined the broader objectives, the scope and sector specific financial innovations or technologies to be tested. The guidelines also include clear eligibility criteria, governance structures, and compliance requirements. SECP RSB structure is defined in multiple phases in fig 2 below.

Development Phase	Launch Phase	Evaluation Phase
Research and Benchmarking Global best practices in regulatory sandboxes , studying models from countries like the UK, Singapore, and Australia.	**Application Window Opened** In 2020, the regulatory sandbox, invited applications from innovators and startups.	**Performance Review:** Since its launch, RSB has successfully completed three cohorts, with a fourth, initiated in 2023, nearing to completion. The performance of each cohort has been published through position papers and regulatory adjustments.
Stakeholder Consultation Engaged with various stakeholders, including fintech companies, financial institutions, and consumer groups, to gather insights and feedback.	**Application Process** Accepted applications in a simple transparent manner through dedicated email address.	**Outcome Analysis:** After the successful completion of each cohort, necessary regulatory updates were made to ensure the framework stays adaptive and continues to support innovation.
Framework Design Developed comprehensive guidelines outlining the objectives, processes, and criteria for participation in the sandbox.	**Selection Criteria** Implemented objective selection criteria based on the innovation, impact, readiness, and consumer benefits.	**Position Papers:** SECP has published two position papers summarising the results and impacts of first two cohorts. A third paper for the cohort is in progress. these documents highlight the sandbox's testing models and their market impact.

Figure 2: Phases of RSB (Cohort Based)

The broader objectives of RSB are to cultivate a vibrant and resilient financial ecosystem. Though the primary focus is the promotion of innovation, allowing for the evaluation of new financial technologies and business models within a controlled setting. Inclusion, a core objective, ensures that various demographic groups have access to financial products and services. This commitment seeks to close gaps within the financial sector, thereby promoting broader economic engagement and fairness.

The sandbox aims to provide a structured and transparent framework for experimentation, ensuring that new technologies can be tested within a controlled environment. Additionally, it emphasizes consumer protection by prioritizing financial stability and safety, while also enhancing the competitiveness of the sector. Lastly, the sandbox seeks to promote financial inclusion, ensuring that the benefits of innovation extend to all segments of society.

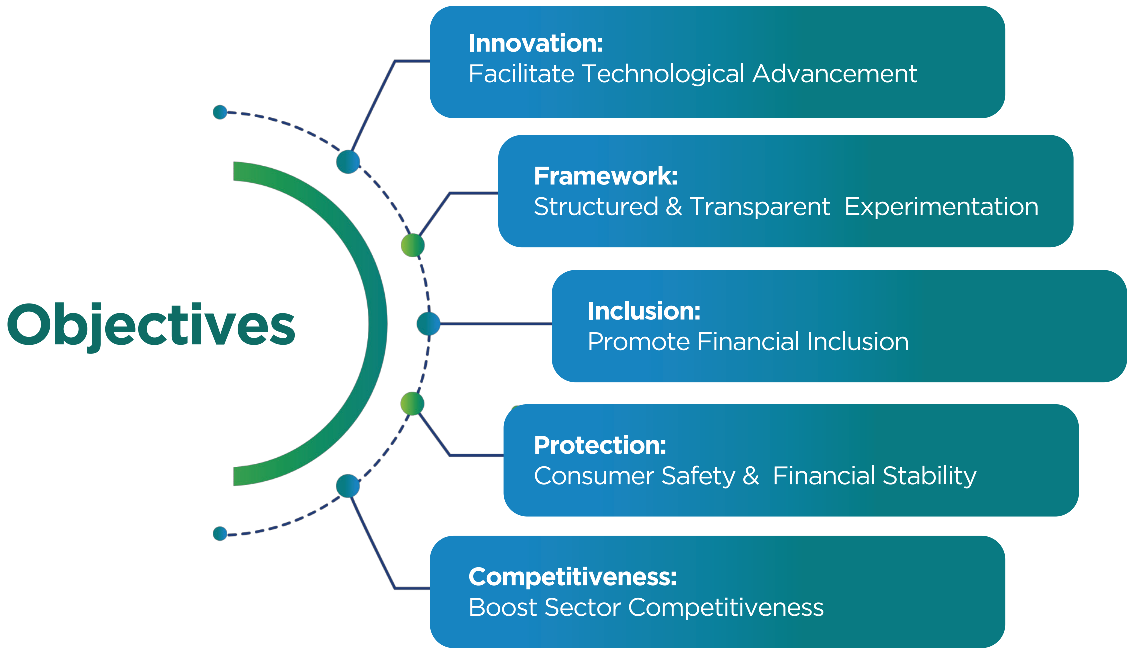


Figure 3: Objectives of Regulatory Sandbox

These objectives collectively drive the SECP RSB's mission to develop a forward-thinking, inclusive, and competitive financial environment while upholding crucial protections and a well-defined regulatory framework.

(a) Sandbox as an SDG Enabler

Offering innovative and forward-looking solutions with substantial potential to advance the 2030 Agenda for Sustainable Development. Nevertheless, as digital technologies become more sophisticated and pervasive, they also introduce new risks and intensify threats for both the regulators and users, including data breaches, digital fraud, privacy issues, and cybersecurity vulnerabilities. Emerging technologies such as artificial intelligence, blockchain, 5G, cloud computing, machine learning, the Internet of Things, and robotics have the potential to further exacerbate existing divides among those who are less connected or digitally literate, thereby widening digital, economic, and social disparities. In this context, the effective deployment of regulatory sandbox in Pakistan is the way to address policy and regulatory gaps, striking a balance between necessary regulation and the encouragement of technology-driven innovation. This approach aims to maximize contributions to sustainable development while minimizing the risks associated with emerging technologies.

The SECP RSB serves as a pivotal instrument in advancing Sustainable Development Goals (SDGs) by fostering innovation and inclusivity within Pakistan's financial sector, such as;

i. Through its structured environment, the sandbox allows for the experimentation and deployment of innovative financial technologies and business models that can drive economic growth and efficiency, aligning with SDG 8 (Decent Work and Economic Growth).

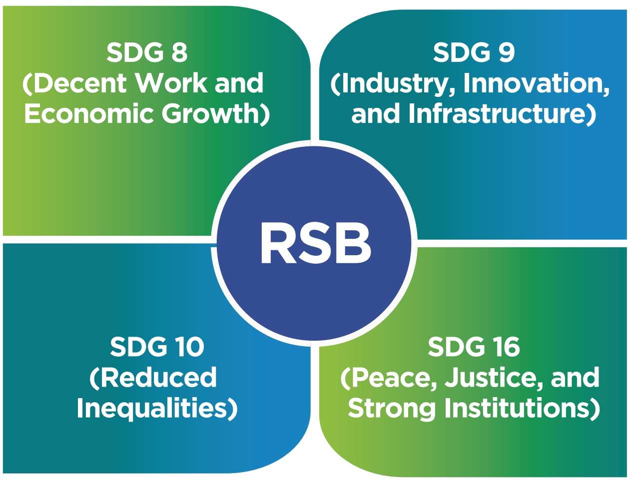
ii. By encouraging diverse market participants and new entrants, the RSB promotes greater competition and consumer choice, supporting SDG 9 (Industry, Innovation, and Infrastructure) and SDG 10 (Reduced Inequalities) through improved access to financial services for underserved populations.

iii. The sandbox also emphasizes investor protection and risk management, contributing to SDG 16 (Peace, Justice, and Strong Institutions) by maintaining market integrity and ensuring robust regulatory oversight.

iv. Moreover, by integrating sustainable practices and promoting financial inclusion, the SECP Regulatory Sandbox aligns with SDG 1 (No Poverty) and SDG 5 (Gender Equality), as it supports efforts to reduce poverty and advance gender equality by providing equitable access to financial resources.

Overall, the SECP RSB's strategic approach to innovation, competition, and inclusion directly contributes to the broader agenda of sustainable development by creating a more resilient, inclusive, and equitable financial ecosystem. Figure 4 provides a comprehensive overview of SDG link with RSB.

Figure 4: RSB and SDG



(b) SECP Regulatory Sandbox Design

International experiences indicated common features that are integral to a sandbox, for effectively influence the broader business environment. Regardless of whether it is referred to as a regulatory, innovative, or fintech sandbox, these platforms share certain common features globally. The key pillars, depicted in fig 5 below, lay the foundations for the RSB to perform effectively and deliver significant impact in terms of innovation and regulatory adaptation.

Figure 5: Key Features of SECP RSB

(c) Impact Unveiled: A Comprehensive Review

In last four years, SECP sandbox operated in cohorts, each focusing on specific areas such as digital lending, insurance, asset management services, digital broker services, algorithmic trading etc. Participants received temporary regulatory relief, allowing them to operate with greater flexibility. In return, they adhered to conditions and limitations set by the SECP, such as reporting requirements and consumer protection measures.

The business models tested are customer-centric and have significantly shaped the market landscape. The initiative has attracted considerable interest from a wide range of participants, including established corporations, international firms, start-ups, and fintech companies. To date, the SECP has received over one hundred and twenty-five applications, with thirty successfully approved to test their innovative solutions within the sandbox. The market's response has been consistently strong, with each cohort receiving an average of thirty applications. The cohort-based approach journey provided in figure 6, has given the commission valuable experience in managing resources, evaluating applications, and selecting participants effectively.

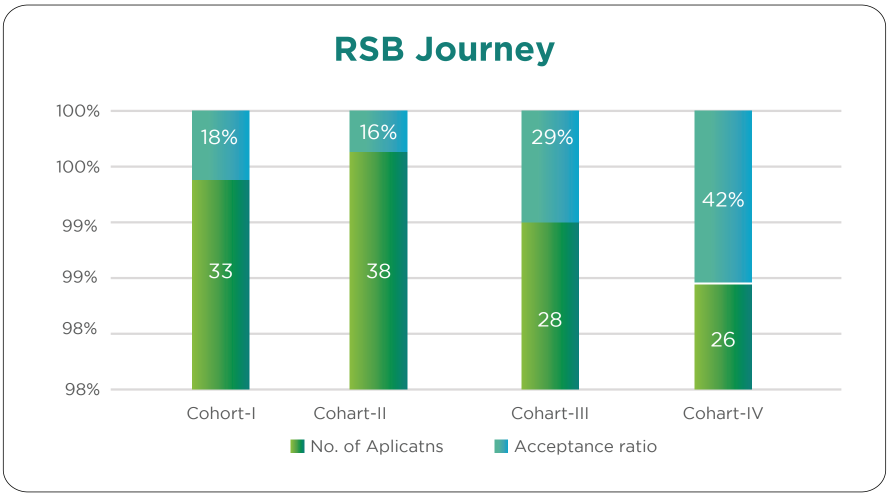


Figure 6: RSB Cohorts Journey

SECP has played crucial role in driving digital transformation across a wide range of regulated sectors by enabling end-to-end digital solutions and introducing digital-only licenses. This significant advancement became possible through the SECP Regulatory Sandbox, which provided an insight on all such business models while being tested under controlled environment of RSB. By encouraging the experimentation of ideas such as innovative product development, alternate financial intermediation platforms, crowdfunding, digital assets, and AI-driven solutions, the sandbox has allowed the SECP to assess potential risks and identify optimal opportunities for market disruption. As a result, the SECP has been able to foster a more agile and technologically advanced financial ecosystem, ensuring that digital transformation is both comprehensive and sustainable across its regulated sectors.

(d) Achievements of RSB

Over its cohort-based journey, the sandbox has provided invaluable insights and learnings, leading to the development of a comprehensive regulatory framework tailored specifically for these emerging sectors. Few of the enabling regulatory changings made to promote the business at commercial level pertaining to these emerging sectors are shown in figure 7 below.

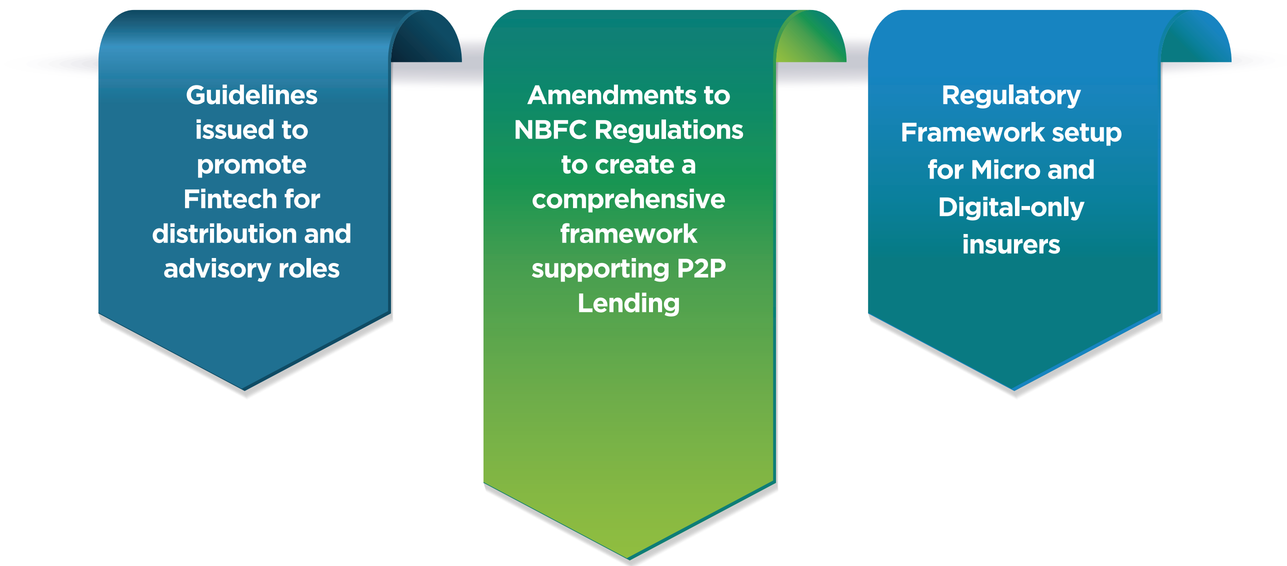


Figure 7: Amendments in Rule/Regulations of Framework

RSB experience revealed a robust market demand for innovative financial services, underscoring the potential to capitalize on the emerging opportunity. Currently, several applications are under rigorous scrutiny as entities seek to either integrate these verticals into their existing product lines or acquire licenses for standalone commercial launches. The successful outcomes from these sandbox tests have not only validated the market potential but also provided formal regulation to ensure safe and efficient market entry.

This process exemplifies how the SECP's sandbox initiative has effectively bridged the gap between innovation and regulation, paving the way for these transformative financial services to make a significant impact on Pakistan's financial landscape. Peer-to-peer (P2P) lending platform, digital mutual fund distribution, digital insurance, Algorithmic trading, digital brokers etc. all verticals tested in RSB have the potential to significantly disrupt and enhance Pakistan's financial outreach by increasing financial inclusion and contributing to economic growth.

P2P lending platforms can democratize access to credit, addressing the substantial credit gap where only 23% of adults in Pakistan have access to formal financial services, as reported by the World Bank. P2P lending platforms can democratize access to credit, addressing the substantial credit gap where only 23% of adults in Pakistan have access to formal financial services, as reported by the World Bank.

Digital mutual fund distribution simplifies investment processes, potentially increasing market participation; currently, only 2% of Pakistan's population invests in mutual funds, indicating a vast untapped market.

Digital insurance solutions can address the low insurance penetration in Pakistan, which stands at a mere 1% of GDP compared to a global average of 6.1%, through more accessible and affordable insurance products.

Digital brokers & algorithmic trading platforms are revolutionizing Pakistan's financial markets by providing greater access and efficiency to investors. They enhance market liquidity and reduce transaction costs through automated trading strategies.

Figure 7: Amendments in Rule/Regulations of Framework

By leveraging technology to make financial services more accessible and efficient, these innovations have the potential to not only boost individual financial security but also stimulate broader economic growth, thereby contributing to the country's overall development and prosperity.

The regulatory reform in the fintech sector, as demonstrated by RSB's sandbox initiative, greatly benefited innovative lending solutions like COD financing, invoice discounting, and innovative lending marketplaces. By providing a structured environment for testing these solutions, the SECP allows innovators to pilot new approaches under real-world conditions. This hands-on testing phase helps regulators understand the performance and impact of these technologies, ensuring they can refine regulations to address practical challenges.

From an investment perspective, robo-advisory and digital mutual fund distribution models drive innovation in the investment sector while allowing regulators to develop frameworks that support and facilitate these digital solutions. This proactive regulatory approach ensures that as fintech advances, regulations evolve accordingly, balancing innovation with effective oversight.

The regulatory sandbox has been instrumental in allowing the testing of new models before their commercial launch, which provides thorough assessment of the risks associated and market sentiment related to the entity's offerings. By reducing regulatory and financial barriers, the sandbox has significantly lowered the entry threshold for start-ups and small to medium-sized enterprises (SMEs) in the financial sector. This support not only facilitates entrepreneurial activity but also cultivates a more dynamic start-up ecosystem. It provides essential opportunities for innovation, enabling new players to experiment and refine their solutions without facing the high costs and regulatory uncertainties that typically challenge early-stage ventures.

Through the sandbox, the SECP encouraged an open dialogue with innovators, financial institutions, and other stakeholders. This collaboration has led to a more dynamic and responsive financial ecosystem, where regulatory practices can be adjusted based on practical insights and feedback from the market. The strengthened partnership between regulators and the private sector will contribute to a more agile and informed approach to financial regulation, benefiting both the industry and consumers.

Overall, the SECP Regulatory Sandbox has not only driven fintech innovation but has also fostered a more inclusive and adaptive regulatory environment. By balancing the need for oversight with the encouragement of entrepreneurial spirit, the sandbox has played a key role in shaping a progressive and resilient financial sector in Pakistan. Since its inception, the RSB has reached numerous milestones, with innovative disruptions standing out above all. A snapshot of these achievements is shown in Figure 8.

Figure 8: Achievements of RSB

3. Challenges and Lessons Learned

New initiatives invariably encounter challenges, which present valuable opportunities for learning and refining strategies. The four cohorts of the RSB have yielded crucial insights into financial services innovation and regulatory adaptation, highlighting the need to balance innovation with regulatory requirements. Ongoing adaptation will continue to be crucial for the RSB's success, showcasing strategic adjustments that can lead to success even with limited resources. These challenges can be classified as:

Figure 9: RSB Challenges

(a) Balancing Innovation and Regulation

Finding the equilibrium between fostering innovation and maintaining rigorous regulatory oversight represents a significant challenge. Overregulation can stifle creative efforts and delay the introduction of beneficial technologies. Conversely, insufficient regulation might lead to unchecked risks and vulnerabilities. Therefore, a balanced approach is essential.

SECP regulatory sandbox in past four years strived to strike a careful balance between fostering innovation and ensuring regulatory oversight while maintaining appropriate safeguards. Within the past four cohorts of sandbox, innovators were allowed to experiment their solutions under relaxed regulatory constraints, allowing them to demonstrate their viability and address potential issues in a real-world setting. At the same time, the SECP closely monitored these activities, ensuring that participants adhere to minimum compliance standards and consumer protection measures. To keep the innovation alive and pace with the advancement of the world, RSB has allowed different business cases to test their models by utilizing distributed Ledger Technology (DLT) in financial services. The fact that DLT may pose big challenge in terms of data and cyber security, the RSB has hosen to rigorously test these technologies to identify and assess associated risks and issues. This approach allows the RSB to thoroughly evaluate the impact of these innovations on the financial ecosystem and to refine regulatory frameworks based on empirical evidence.

Ensuring timely readiness for the testing phase has posed a considerable challenge for the RSB. To address this, innovators are allowed an incubation period of two months to achieve operational and technical readiness before commencing their business model testing. However, completing the testing within the allocated six-month timeframe has also proven to be difficult. Throughout cohorts I to IV, multiple applicants have requested extensions, suggesting that the testing duration may be insufficient or the operational issues at entity level has consumed excessive time. Additionally, some business models require more time than initially anticipated to yield the desired results.

In response, commission has provided timely extensions to maintain the success rate of these business models. Based on feedback and the learning process from the first four cohorts, the SECP RSB has decided to extend the testing period from six months to twelve months, effective August 2024. This extension aims to offer sufficient time for testing innovative business models and allows entities to project their success rates as initially envisioned. By facilitating a collaborative dialogue with innovators and continuously reviewing and updating regulations, the SECP learned that the rive for technological advancement must not come at the expense of market integrity and onsumer n. This balanced methodology helps to support the growth of new technologies while mitigating risks and maintaining a stable and fair financial environment.

(b) Resource Constraints

Resource constraints are a persistent challenge faced by regulatory bodies overseeing emerging technologies within sandbox environments. The rapid pace of technological development, coupled with the complexity of new digital models, often outstrips the regulatory capacity and expertise available. Regulators may struggle with limited staff and insufficient specialized knowledge necessary to effectively assess and manage innovative technologies. Additionally, the cost of monitoring and supporting sandbox participants can strain budgetary resources, making it difficult to provide comprehensive oversight.

The SECP's regulatory sandbox is currently funded exclusively through internal resources. However, learnings over the past four years indicate that establishing partnerships and connections with both international and national associations could significantly enhance its impact. Collaborating with local and global financial institutions, technology firms, and philanthropic organizations invested in advancing financial technology could provide both financial support and technical expertise. By forming strategic alliances and pursuing targeted grants, the SECP could successfully bridge the gap between innovative ideas and their successful implementation.

(c) Continuous Adaptation

The fast-evolving nature of fintech and digital solutions necessitates ongoing adaptation of regulatory frameworks to keep pace with technological advancements and emerging market dynamics. The rapid development of new technologies often presents novel challenges and opportunities that existing regulations may not adequately address.

Effective continuous adaptation requires iterative regulatory reviews, integrating feedback from SECP sandbox participants and industry stakeholders, and staying alert to technological trends. Previous cohort learnings highlight the benefits of a proactive, iterative regulatory approach for managing technological advancements, supporting innovation, and protecting consumer interests. However, maintaining this balance between flexibility and robust regulatory standards is complex, as it involves fostering innovation while ensuring market integrity. This continuous adaptation calls for considerable resources and a proactive strategy to effectively anticipate and tackle emerging trends and challenges in the fintech sector.

4. New Horizons: Learnings

By September 2023, in response to industry feedback and the growing need for a more flexible and adaptive regulatory framework, the SECP transitioned from a cohort-based approach to an always-open sandbox model. This shift was aimed at providing innovators with the flexibility to engage with the regulator at their own pace and timing, thereby facilitating continuous innovation and reducing the time to market for new financial products and services. The always-open sandbox model reflects the SECP's commitment to nurturing a dynamic fintech ecosystem in Pakistan, capable of competing on a global scale.

To streamline the application process for applicants year-round, the RSB has established a dedicated section on the official SECP website. This section offers detailed application guidelines and includes a self-assessment tool designed to help applicants evaluate the suitability of their business models. By providing these resources, the RSB aims to facilitate a more efficient application process and ensure that applicants have the necessary information to prepare their submissions effectively.

The SECP's transition to an always-open sandbox model is a notable measure in very short span of its life cycle, demonstrating a more flexible and responsive regulatory approach compared to the cohort-based models traditionally used by the regulators across the globe. This move positions the SECP as a progressive regulator, willing to adapt and evolve in line with industry needs. It underscores the SECP's commitment to support continuous innovation and reflects an understanding of the dynamic nature of the fintech landscape.

From 2019 to 2024, the RSB has evolved significantly, aligning with global best practices while meeting Pakistan's fintech needs. Its innovative always-open model sets a new standard for regulatory flexibility, enhancing Pakistan's global fintech position and driving growth. Though this transition will significantly enhance the flexibility and accessibility for innovative financial models, this initiative now accommodates three specific categories of business models: Conventional, Islamic, and Women-Led enterprises. By categorizing the sandbox in this manner, SECP aims to foster diverse financial innovations that cater to varying market needs, including traditional finance, Sharia-compliant solutions, and initiatives led by women entrepreneurs.

In the four cohorts of the RSB, it has become evident that the six-month testing period is insufficient for developing a viable business case capable of scaling up to a commercial level. As a result, participants have frequently requested extensions across all cohorts. While the commission has granted multiple extensions to same applicant of cohort. Globally, testing periods vary significantly, ranging from six to thirty-six months. Based on feedback from the industry and previous participants, and in light of rapid technological advancements, it is observed that a six-month period is inadequate for successful testing and graduation. Therefore, based on feedback from different spheres the testing period of RSB extended to a minimum of one year in 2024.

5. Chronicles of RSB

(A) Unlocking Financial Potential: The Game-Changing Impact of P2P Lending

This innovative financial model can enhance financial inclusion by connecting borrowers directly with lenders, thereby providing crucial funding for small businesses and individuals who may lack access to conventional banking resources. The opening of financing avenues through P2P platforms offers a range of benefits, outlined below.

(i) Enhancing Financial Inclusion

Peer-to-peer (P2P) lending platforms facilitate access to credit for entities and individuals who are excluded from traditional banking systems due to insufficient collateral or a limited credit history. This mode of lending addresses the credit gap by connecting borrowers directly with lenders, bypassing conventional barriers. Furthermore, the expansion of P2P lending is closely linked to the broader growth of digital financial services in Pakistan.

(ii) Supporting SME Growth

SMEs, which form a substantial part of Pakistan's economy, gain considerable benefits from the ease and speed of accessing loans through peer-to-peer (P2P) lending platforms. These platforms streamline the loan process, enabling SMEs to secure financing more efficiently, which in turn fosters entrepreneurship and stimulates economic growth. By supporting the expansion of SMEs, P2P lending not only helps businesses thrive but also plays a crucial role in job creation and broader economic development. As SMEs grow and succeed, they contribute to the overall health of the economy, generating employment opportunities and driving economic progress.

(iii) Building Market Trust

The regulatory oversight and sandbox environment play a crucial role in ensuring that consumer protection measures are effectively implemented, thereby enhancing trust in peer-to-peer (P2P) lending platforms. By maintaining rigorous standards and monitoring practices, the sandbox fosters a secure and transparent framework that reassures consumers about the safety of their investments. Additionally, clear regulatory signals provided by the sandbox attract investors, which boosts market confidence and increases liquidity. This clarity in regulation not only draws investment but also reinforces the stability and credibility of the P2P lending sector, contributing to its overall growth and success.

(a) P2P Lending: South Asian perspective

In South Asia, peer-to-peer (P2P) lending is rapidly evolving, presenting significant opportunities for financial inclusion and economic growth. Countries like India have developed advanced regulatory frameworks to support P2P platforms, while Bangladesh and Pakistan are in earlier stages of adoption with promising potential. This innovative financial model offers crucial access to credit for underserved populations, bridging gaps left by traditional banking systems.

The following comparative table outlines key aspects of P2P lending in India, Bangladesh, and Pakistan:

Table 2: Jurisdictional Analysis of P2P

Aspect	India	Bangladesh	Pakistan
Regulatory Authority	Reserve Bank of India (RBI)	Bangladesh Bank	Securities and Exchange Commission of Pakistan (SECP)
Regulatory Framework	Advanced and progressive; regulated by the Reserve Bank of India (RBI) with a structured regulatory sandbox.	Nascent; the Bangladesh Bank is beginning to explore regulatory measures with limited regulatory clarity.	Newly established; SECP introduced a comprehensive regulatory framework in 2022 following successful sandbox testing.
Market Maturity	Highly developed; well-established with significant growth.	Emerging; still in formative stageswith promising growth.	Developing; not yet mature but progressing with recent regulatory developments.
Growth Rate (Last 3 Years)	High, with steady growth in platforms and transactions	Low, with gradual increase in activity	Steady, with potential for growth
Consumer Protection	Strong; RBI's framework ensures investor and borrower protection.	Limited; emerging regulatory measures aim to improve consumer protection.	Enhancing; SECP's guidelines are designed to ensure operational and compliance standards.
Investment Attraction	High; clear regulations attract both local and international investors.	Moderate; growing but still faces challenges due to regulatory uncertainty.	Increasing; recent regulatory clarity is enhancing investor confidence.
Financial Inclusion	Significant; helps bridge the gap for individuals and small businesses lacking traditional banking access.	Potential; gradually addressing needs of underserved populations and small enterprises.	Potential; aims to provide financial services to underserved communities.
Opportunities	Financial inclusion, SME support, technological innovation	Financial inclusion, underserved market access	Financial inclusion, entrepreneurial support
Challenges	Limited; relatively stable with awell-regulated environment.	Uncertainty; lack of regulatory clarity and low financial literacy impact adoption.	Initial obstacles include limited market penetration and trust issues among users.Financial Literacy required.

Though India leads in terms of regulatory maturity and market penetration, Bangladesh at earlier stages of P2P lending development while Pakistan has provided a comprehensive framework after successful sandbox testing. Each jurisdiction faces its own set of challenges and opportunities, with varying degrees of regulatory clarity and market readiness. As the sector evolves, continued attention to regulatory frameworks, market conditions, and financial literacy will be crucial for fostering sustainable growth in P2P lending platforms.

(b) P2P Sandbox testing

P2P testing was carried out in first cohort of sandbox in 2020. The sandbox piloting of P2P lending showcased promising market demand, as evidenced by key performance indicators. A total loan volume of PKR 700 million ($2.4 million) was achieved, distributed across 28,500 individual loans, with an average loan size of PKR 25,000 ($88). The platform successfully engaged 400 lenders and 6,500 borrowers, highlighting a balanced and active ecosystem. Monthly issuances reached PKR 100 million ($350k), indicating robust and sustained transaction activity. This data suggests that the P2P lending model has been well-received, meeting the needs of both lenders and borrowers effectively, thereby demonstrating the potential for scalable growth within the financial landscape.

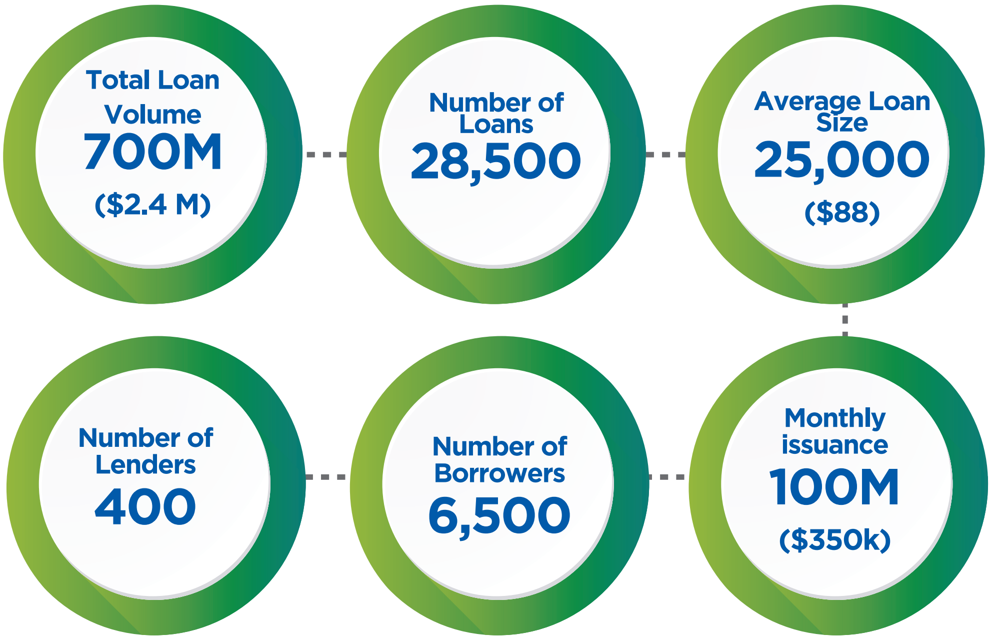


Figure 9: Sandbox Journey of P2P

The P2P sandbox testing has undoubtedly offered valuable insights, enabling the development of a robust framework for market participants. Spanning over more than a year, this testing allowed the SECP to identify various risks and regulatory needs, ensuring effective consumer protection.

(c) P2P Lending Goes Live: Unveiling the Future After a Robust Framework

Following a successful sandbox testing phase, the commercial launch of P2P lending has demonstrated significant market demand and robust financial activity. The transition from the sandbox testing to commercial launch and work under comprehensive regulatory framework, has lifted previous restrictions, allowing the platform to operate on a larger scale. The results have been impressive, with the total loan volume reaching PKR 1.2 billion as of March 2024, distributed across 38,000 loans, and an average loan size of PKR 30,000. The platform supports 400 investors and 7,000 borrowers, reflecting a well-balanced and dynamic financial ecosystem. Monthly issuances have maintained a steady flow, with PKR 100 million being processed regularly. This substantial growth in volume and participation highlights the commercial viability and strong demand for P2P lending, confirming its potential to significantly impact the financial landscape by providing accessible financing solutions to a broader audience.

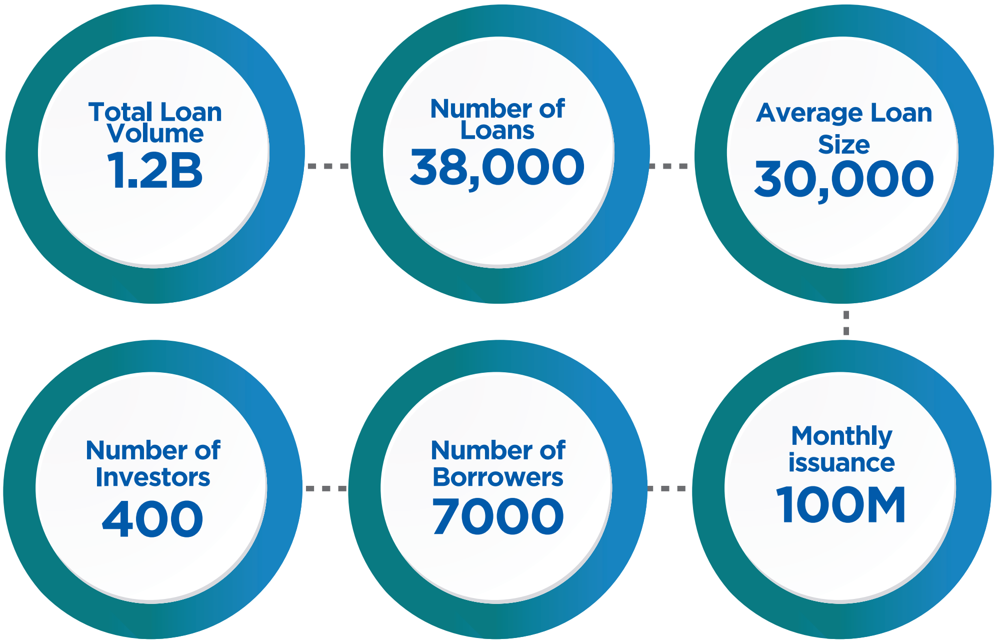


Figure 10: Commercial Launch of P2P in Pakistan

(d) From Sandbox to Success: The P2P Journey from Testing to Market Launch

The journey of Peer-to-Peer (P2P) lending from the regulatory sandbox to a full commercial launch has been marked by significant milestones. The transition from testing to market has not only validated the business model's robustness but also highlighted its capacity to meet a growing demand for alternative financing. This success underscores the importance of regulatory frameworks that enable innovation while ensuring market stability and consumer protection.

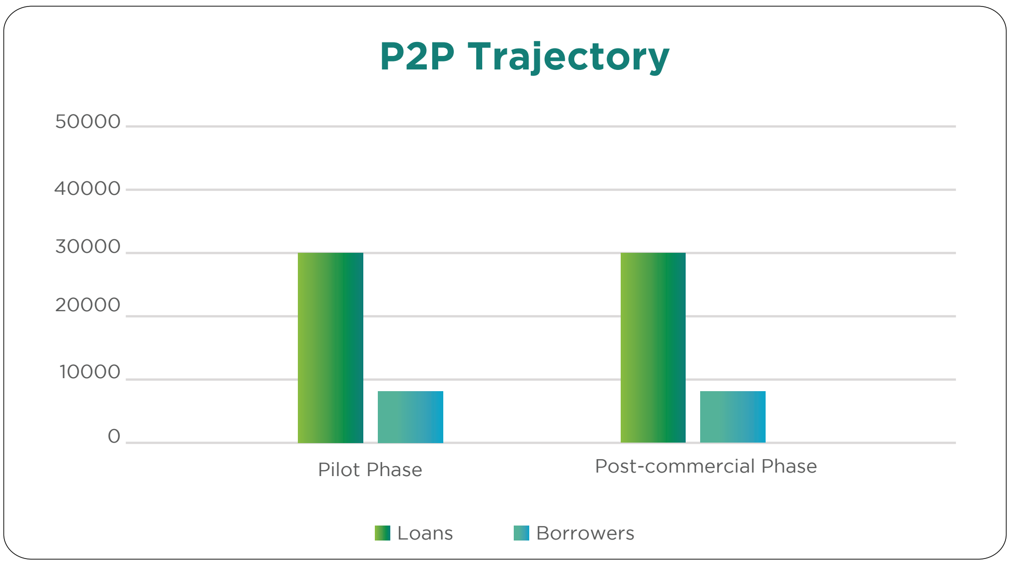


Figure 11: P2P Testing to Commercial Phase

This new regulatory environment has opened opportunities for the sector, numerous business applications are currently in the registration/licensing process. In meantime SECP is initiating a dialogue to assess the existing limits on investors and borrowers to align with the growth needs of the market. It is being assessed that by enhancing these limits, how the P2P lending market could attract more substantial investments and provide more diverse financial products.

(B) Digital Mutual fund distribution

Over the past four years, Pakistan's mutual fund sector has experienced significant growth, driven by increasing investor awareness and favorable regulatory reforms. However, despite the sector's expansion, there remains a notable resistance among retail investors to invest in mutual funds. This reluctance stems from a traditional preference for safer asset classes such as real estate and gold, which are perceived as more secure and stable investments. The cultural inclination towards tangible assets, coupled with a lack of financial literacy and market volatility, has contributed to this enduring investment behaviour among the retail segment.

Women's participation in mutual fund investments in Pakistan remains relatively low or nearly negligible as compared to their male counterparts. Despite efforts to promote financial inclusion, cultural norms and a lack of targeted financial education have limited women's engagement in the mutual fund sector.

To address gender diversity and strengthen governance structures, the Securities and Exchange Commission of Pakistan (SECP) has introduced measures to enhance the representation of women in the boards of mutual fund companies. These measures include:

i. Gender Diversity Guidelines: The SECP has issued guidelines encouraging companies to ensure a certain percentage of women representation on their boards, promoting diversity and inclusivity in decision-making processes.

ii. Mandatory Female Representation: The SECP has mandated that listed companies, including those in the mutual fund sector, have at least one female director on their boards. This policy aims to ensure that women have a voice in the governance and strategic direction of these companies.

iii. Capacity Building and Training: Initiatives to build the capacity of women in the financial sector through training programs and workshops have been undertaken. These programs aim to equip women with the necessary skills and knowledge to take on leadership roles within the industry.

iv. Public Awareness Campaigns: The SECP has also launched public awareness campaigns to highlight the importance of gender diversity in corporate governance and to encourage more women to participate in financial investments, including mutual funds.

These efforts are part of a broader strategy to create a more inclusive financial sector, ensuring that the governance structures of mutual funds benefit from diverse perspectives and expertise.

(a) Women Investors: A Jurisdictional Insight into Retail Mutual Funds

Female participation in mutual funds varies significantly across India, Pakistan, and Bangladesh. In India, women represent about 27% of investors, supported by targeted financial literacy programs and a supportive regulatory framework. In contrast, Pakistan and Bangladesh see lower participation rates, influenced by cultural preferences for safer assets and limited financial literacy, despite ongoing efforts and regulatory measures to enhance gender diversity and financial inclusion.

The table below highlights the disparities in female participation in the mutual fund sector across these South Asian countries, influenced by cultural norms, financial literacy, and regulatory efforts.

Table 3: Jurisdictional Analysis of Retail Mutual Funds

Aspect	India	Pakistan	Bangladesh
Female Participation Rate	Approximately 27% of retail mutual fund investors.	0-5% of investors.	10-15% of investors.
Cultural Influences	Higher participation due to progressive cultural norms.	Preference for safer assets like real estate and gold.	Similar preference for traditional assetclasses.
Financial Literacy	Enhanced through targeted educational campaigns and initiatives.	Limited financial literacy impacting engagement.	Financial literacy campaigns initiated but still limited.
Regulatory Initiatives	Supportive regulatory framework promoting inclusivity.	SECP measures including mandatory female board representation and capacity-building programs.	Initiatives to improve financial inclusion but limited specific investment products for women.
Investment Products	Development of women specific investment products.	Limited development of women-targeted investment products.	Limited availability of targeted investment products for women.

To promote increased female participation in the formal financial system, the SECP Regulatory Sandbox has consistently supported female-led and women-focused innovative business models. A dedicated application window for women has been established to accommodate these applications. Following thorough scrutiny, these entities are encouraged to test their models within a controlled environment, thereby advancing financial inclusion. One notable business model tested in second cohort of RSB in 2021, which not only generated market demand for its product but also raised financial awareness among women, emphasizing the importance of savings alongside consumption.

The applicant aimed to boost financial inclusion by testing a straightforward investment product through an online mutual fund distribution platform tailored for women. Collaborating with a registered mutual fund, the applicant sought to implement a seamless onboarding process and attracted up to 4,000 clients during the sandbox phase. Despite facing delays due to the lower technological proficiency of Asset Management Companies (AMCs) in Pakistan in 2021-2022, the applicant successfully launched the product, generating significant interest among female clients. The whole journey of the platform is depicted in fig12.

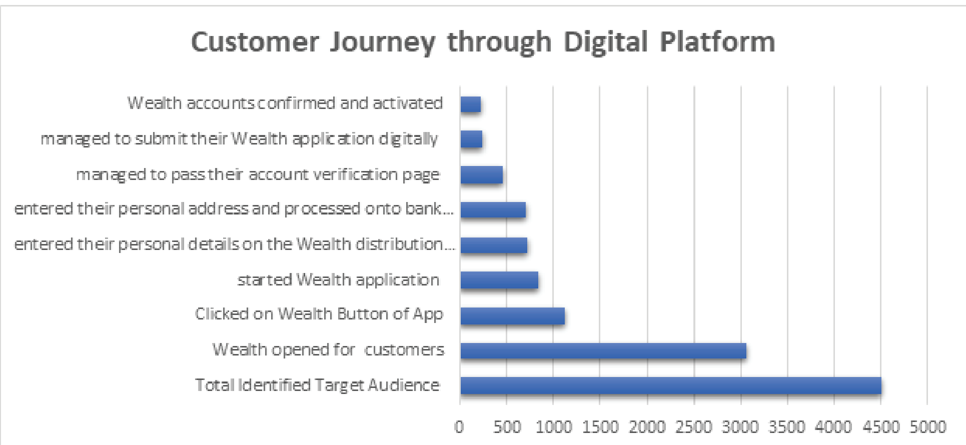


Figure 12: Journey of Mutual fund distribution testing under RSB

Despite challenges faced by innovator during testing phase in sensitizing the female clients to educate for investment in mutual funds industry of Pakistan, the applicant successfully engaged good number of females to invest in dedicated mutual fund digitally and the Assets Under Management (AUM) rose to 300,000 PKR in a month time span as shown in fig13.

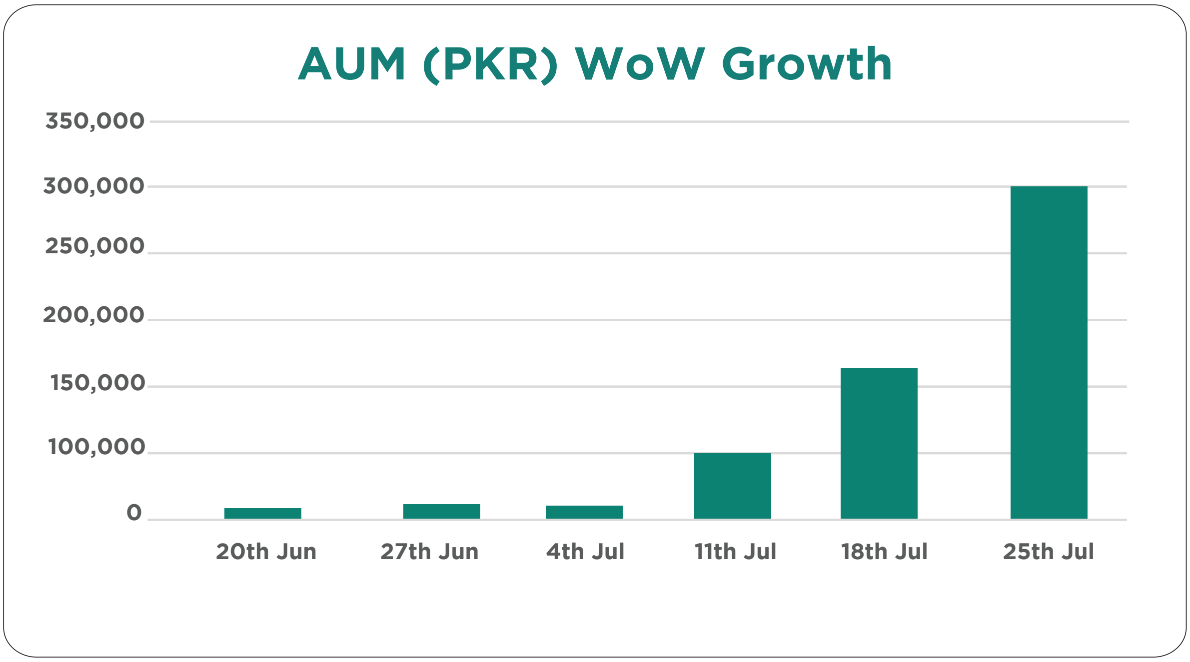


Figure 13: WoW AUM growth

This indicates a strong demand for investment, accompanied by a need for broader financial literacy. The primary challenge, however, is simplifying investment processes to avoid lengthy paperwork and utilizing digital tools to facilitate easy access to information and investment opportunities. Furthermore, this data highlights the critical role of financial literacy in significantly expanding the retail client base within the mutual fund sector.

After analyzing the testing results of the applicant, following major points can be observed;

i. **Demand for Mutual Funds:** The overall trend shows a clear demand for mutual funds, as evidenced by the significant increase in AUM within a month.

ii. **Ease of Investment:** It was also observed that simplifying the investment process (e.g., reducing the need for lengthy forms) and utilizing digital platforms can encourage more investors to participate.

iii. **Financial Literacy:** The importance of financial literacy is highlighted, as better-informed investors are likely to contribute to sustained growth in the mutual fund sector.

iv. **Potential Barriers:** Initial slow growth may indicate potential barriers such as lack of awareness, complicated investment processes, or insufficient investor education.

The sandbox testing revealed various challenges, including technological advancements required for Asset Management Companies (AMCs), low financial literacy, and a lack of incentives for retail investors within the mutual fund industry. The data corroborates the presence of retail demand, but future growth will hinge on the provision of better incentives for investors and enhanced technological capabilities of AMCs to facilitate easier customer onboarding.

Future Outlook

In the Global Innovation Index 2023, Pakistan is ranked 88th out of 132 economies. Among 37 middle-income countries, it holds the 12th position, and it ranks 5th among 10 Southern and Central Asian economies. This progress is notable, as Pakistan has risen from 107th in 2020 to 88th in 2023. Initiatives like the RSB plays a crucial role in fostering innovation, offering a platform for testing business models in areas where the regulatory landscape is still developing, prior to their commercial launch. The RSB's journey is a testament to the power of collaboration, forward-thinking regulation, and the transformative potential of fintech in Pakistan. By continuously refining its framework and expanding its scope, the SECP aims to foster an innovation-friendly ecosystem that supports financial advancements while maintaining regulatory integrity. The ongoing success of the RSB program serves as an inspiration for developing frameworks that balance innovation with robust consumer protection, ultimately driving economic growth and digital transformation in Pakistan's financial sector.

The SECP Regulatory Sandbox is poised for transformative advancement as it embraces a multi-faceted approach to nurturing financial innovation. The repositioning of the Innovation Office is expected to streamline and enhance its role in supporting emerging financial technologies, making it a central hub for innovation. This will be complemented by a focus on meaningful handholding, ensuring that participants receive targeted guidance and support throughout their development journey.

The introduction of mentorship moots will further enrich the sandbox environment, connecting innovators with seasoned experts who can provide valuable insights and practical advice. Additionally, the establishment of a structured regulatory framework, articulated through sandbox regulations, will offer clearer guidelines and enhance the regulatory certainty for participants. To bolster these efforts, the SECP plans to engage with multiple donor agencies to provide funding to testing participants, thereby reducing financial barriers and encouraging more robust experimentation. Collectively, these initiatives will foster a more dynamic and inclusive financial landscape, positioning Pakistan as a leader in financial innovation.

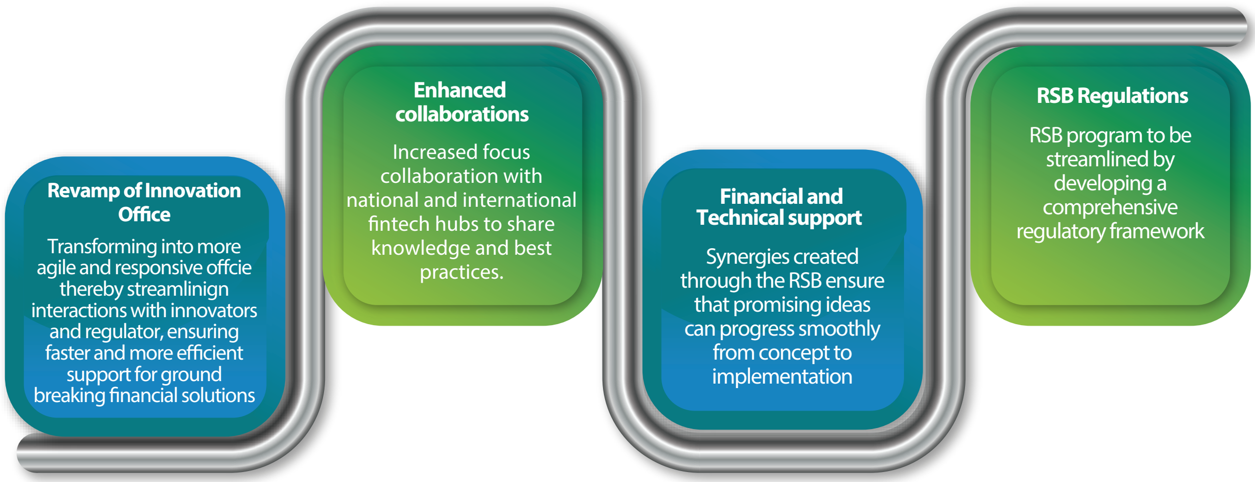


Figure 14: Future Outlook of RSB

Appendix

Regulatory Sandbox Participants

The SECP regulatory sandbox represents a significant step forward in promoting financial innovation in Pakistan. By providing a controlled environment for testing new products and services, the sandbox has enabled start-ups to innovate while ensuring consumer protection and regulatory compliance. The journey so far has been marked by collaboration, learning, and adaptability, laying a strong foundation for the continued growth and evolution of Pakistan's fintech ecosystem.

The success journey of RSB extends beyond a limited set of business models as elaborated in report; numerous participants have effectively tested their models within the RSB framework as depicted in details below. Models such as parametric insurance, digital brokerage insurance, and digital takaful have demonstrated considerable success. However, constraints faced by participants have impeded their commercial launch. Despite successful testing, issues such as low market penetration and limited financial literacy have hindered traction and the anticipated scale-up.

The SECP has proactively encouraged and assisted RSB participants in streamlining the upscaling process, including support with registration and licensing. Nonetheless, many successful participants have chosen to delay their scaling initiatives due to the macroeconomic conditions, opting to wait for more favourable circumstances for a commercial launch.

COHORT-I PARTICIPANTS

- **First Digital General Takaful (Digital General Takaful Provider)**
- **YPAY (Mutual Fund Digital Distribution)**
- **FINJA (Digital P2P Lending Platform)**
- **FINIOX (Robo Advisory)**
- **Pakistan National Investor Portal (Equity Crowdfunding Platform)**
- **WAADA (Digital Insurance Brokerage Model)**

Figure 15: Cohort I Participants

COHORT-II PARTICIPANTS

- **ORAAN (Mutual Fund Digital Distribution)**
- **Innovst Tech (Mutual Fund Digital Distribution)**
- **Sahal Software (Digital Identity/ AML/ KYC)**
- **Salam Takaful (Parametric Insurance)**
- **FracEstate (Asset Fractionalization)**
- **MyQasaar (Asset Fractionalization)**

Figure 16: Cohort II participants

COHORT-iiI PARTICIPANTS

- Insurace Bazaar (Telematics Based Insurance)
- Mahaana Wealth (Digital AMC)
- Salam Takaful (Telematics Based Insurance)
- Trikl (Digital AMC)
- JS Golbal Capital (Banking Sector ETF)
- HBL (Live Stock Fund)
- Qaim (Asset Fractionalization-Govt. Bond)

Figure 17: Cohort III Participants

COHORT-iV PARTICIPANTS

- Al Hilal Securities (Asset Fractionalization)
- AKRU Pak (Asset Fractionalization)
- CG Global (Asset Fractionalization)
- Xstate (Asset Fractionalization)
- Reals (Crowdfunding)
- Diamond Technologies (Asset Fractionalization)
- Loop Financial (Single Window Lending Platform)
- Quantree Pvt (AI Based Algorithmic Trading)
- Ibox7 Pvt. Ltd (Insureance CRM Platform)
- Finclude (Education finance)

Figure 18: Cohort IV Participants

SECP

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