SECURITIES AND EXCHANGE
COMMISSION OF PAKISTAN

CONSULTATION PAPER

CHALLENGES AND POTENTIAL

PEER-TO-PEER AND CROWD LENDING IN PAKISTAN

LENDING & PRIVATE FUND DEPARTMENT
SPECIALIZED COMPANIES DIVISION

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EXECUTIVE SUMMARY

This consultation paper provides an in-depth analysis of the Peer-to-Peer (P2P) lending regulatory landscape in Pakistan, focusing on the evolution, challenges, and proposed amendments to the existing framework. It highlights the case of Pakistan's first P2P lending platform, which was tested in the Securities and Exchange Commission of Pakistan's (SECP) regulatory sandbox, setting a precedent for future fintech innovations.

Background and History

P2P lending has emerged as a significant component of the global fintech revolution, offering an alternative to traditional banking by directly connecting borrowers with lenders through online platforms. In Pakistan, this model gained traction with the testing and launch of a P2P lending platform by a Non-Bank Finance Company (NBFC) that successfully navigated the SECP's regulatory sandbox. This marked a pivotal moment in the country's financial ecosystem, demonstrating the potential of P2P lending to bridge the financing gap for individuals and small businesses.

The platform's case study underscores the growing demand for P2P lending in Pakistan. However, it also highlights the necessity for a robust regulatory framework to protect platform investors (lenders) and ensure the sustainable growth of this sector. The SECP's sandbox provided a controlled environment to test the platform, but broader regulatory measures are required to address the inherent risks associated with P2P lending which were observed once the platform went live on full scale.

Issues and Challenges

A study of the rapid growth of P2P lending platforms in several jurisdictions raises fundamental issues and challenges, particularly concerning the protection of platform investors' (lenders) money. Key concerns include:

Default Risk: The risk of borrower default is a significant challenge in P2P lending, especially in an environment where credit assessments may not be as rigorous as those conducted by traditional financial institutions.

Lack of Collateral: The absence of collateral in many P2P lending arrangements increases the risk for lenders, as they have limited recourse in the event of borrower default.

Scalability: While P2P platforms offer scalability, this also amplifies the risk of systemic issues, particularly if the platforms are not subject to continuous regulatory oversight.

Introduction of Secured and Collateralized Lending with Increased Limits

To mitigate these risks, the paper suggests introducing secured and collateralized lending options within the P2P framework. By requiring borrowers to provide collateral, platforms can offer lenders greater security and reduce the risk of default. This shift could attract a broader base of investors who are currently hesitant to participate in P2P lending due to the perceived risks. Secured and insured collaterals will also allow investors to increase the contributions significantly.

Shift from Escrow to Trust Account Structure

Based on practical difficulties faced by Pakistan's first P2P lending platform, another significant recommendation is the transition from an escrow account structure to a trust account structure for managing funds received on P2P platforms which is also in line with SBP's EMI framework. The trust account structure offers enhanced security for lenders by legally segregating the funds from the platform's operational accounts and an 'A' rated commercial bank or trustee registered with SECP shall maintain this account.

Other Amendments in Lending NBFC Framework

Utilizing the opportunity of having an open discussion on the subject, several other amendments to the NBFC framework are also being considered in the following areas:

a. Ease of doing business
b. Liberalization of NBFC regulatory regime
c. Enhanced consumer protection measures
d. Introduction of new financing product lines and enabling Sharia governance framework
e. Ease of understanding and deletion of redundant provisions

Conclusion

In conclusion, while P2P lending platforms have the potential to revolutionize access to finance in Pakistan, their growth must be accompanied by a strong regulatory framework. The proposed measures, including the introduction of secured lending, the shift to trust accounts, and miscellaneous amendments to the NBFC framework, are crucial steps in ensuring the long-term stability and success of the lending sector in Pakistan.

SECP invites the interested parties to provide their feedback and comments on the proposed regime.

1. INTRODUCTION & BACKGROUND

1.1 P2P – An Alternative to Traditional Finance

In recent years, tech-enabled P2P lending has emerged as an alternative to formal bank lending. P2P lending platforms provide an online marketplace that matches investors willing to lend with borrowers seeking loans, removing the need for traditional financial entities to act as intermediaries. Borrowers may be individuals or businesses, depending on the platform. Likewise, lenders may be individuals or institutions. The global P2P lending market size was valued at $517.2 billion in 2024, and is projected to reach $1,709.6 billion by 2034, growing at a CAGR of 12.7% over the next decade[1]. The key objective of P2P lending is to benefit many segments of the economy at the same time i.e. it boosts the returns for the lenders and reduces the rate of interest for the borrowers. In addition, it aids in providing quick and convenient loans, as P2P lending is entirely an online platform.

With traditional banks being reluctant to lend to smaller companies because of higher default rates, lack of data, and small scale making lending to them less profitable, SMEs face financial challenges quite often. In most OECD countries, SMEs contribute more than 50% of GDP, and some global estimates put this figure as high as 70%. This contribution varies across sectors, and is particularly high in the service industry, where SMEs account for 60% or more of GDP in nearly all OECD countries[2]. Based on these numbers, the economic benefits of improving SMEs access to finance could be substantial. Extending credit to SMEs via alternative lending could also prompt banks to recapture the market share by extending more loans to SMEs and improving the service offered to them as the competition will increase.

1.2 The Sandbox Experience

P2P lending platform was allowed to test under SECP's Regulatory Sandbox by SECP in 2019. By offering a controlled environment during the testing, the P2P lending platform was to operate within pre-defined parameters.
Under the permission, the P2P platform was lending to the Karyana stores in the country in collaboration with Fast-Moving Consumer Goods (FMCGs) and their distributors. The platform used robust credit methodology, built in Machine Learning (ML) and Artificial Intelligence (AI) capabilities to allow for an efficient and streamlined digital lending experience. To safeguard the investors of the Platform, the company operating the P2P platform contributed 20% of capital in every loan disbursed on the platform and also provided investors with a "Loan Buyback" guarantee where an investor can sell their loan back to the Company if their payment has not matured. Following regulatory limits were placed on the platform during the testing period:

Table 1 – regulatory limits on first P2P platform during sandbox testing

Sr.No.	Regulatory Cap	Limits
1.	No. of lenders	50
2.	Maximum No. of loans	5,000
3.	Maximum lending portfolio	Rs. 50 million
4.	Maximum investment per individual lender	Rs. 500,000
5.	Maximum investment per institutional lender	Rs. 5 million
6.	Maximum exposure of a lender to the same borrower	Rs. 100,000

In addition, during the testing period, the fintech company operating the P2P platform closed $9 million in a $10 million series A financing round as per statement made to Menabytes. The

[1] Future Market Insights Global and Consulting Pvt. Ltd. Published on finance.yahoo.com on Thu, Apr 18, 2024
[2] https://webapps.ilo.org/infostories/en-GB/Stories/Employment/SMEs#intro

investment came from ICY Ventures and existing investors BeeNext, Vostok Emerging Finance, Quona Capital and Gray Mackenzie Engineering Services.

After conclusion of the testing period, the performance of the P2P platform was as follows:

Table 2 – performance of first P2P platform during sandbox testing			
Investors		**Borrowers**	
No. of investors	48	No. of Karyana Stores	623
Total lending portfolio	Rs. 20 million	Loans provided	1,132
Accounts on waitlist	500+	No. of cities covered	12
Average investment	Rs. 14,000/store	Delinquency	1.6%
Monthly return	1.6 % – 2.7 %	Loans sold back to platform	14
Loan tenure offered	7, 15, 30 days	Bought back loans recovered	6

1.3 Post Testing

As a result of successful testing, the SECP initiated regulatory amendments in the NBFC Regulations, 2008 (the Regulations) for enabling P2P lending platforms, and in the mean time, on November 8, 2021, allowed the platform to be operated and managed as a permitted activity in terms of regulation 29(1)(t) of the Regulations until promulgation of specific regulatory framework applicable to P2P Lending, subject to the following operational conditions, among others (AML & reporting conditions):

Table 3 – operational conditions imposed on P2P platform during permission under 29(1)(t) of the NBFC Regulations	
Operational Limits	**Criteria**
Cap on maximum lending	Maximum 10,000 loans with a total portfolio not exceeding Rs. 100 Million.
Cap on number of maximum lenders	No. of lenders not to exceed 50 new lenders/investors per month.
Contribution by the platform in lending	Platform will contribute at least 20% in each loan
Cap on lending by a single lender	Maximum limit for: a) a single lender, who is an individual, sole proprietor, provident/gratuity fund, trust, charitable institution and section 42 company is Rs.1 Million; b) Other Lenders is Rs. 10 Million.
Cap on lending to a Single Borrower	Maximum Rs. 100,000 and Minimum Rs. 1,000
Maturity of loans	The maturity of loans shall not exceed 30 days
Exposure of Single lender to the same borrower	Shall not exceed Rs. 100,000
Eligibility of Lender	Lenders must be high net worth persons having net worth of at least Rs. 15 million excluding personal residence.
Eligibility for Borrower	Shall be assessed on factors including purchase history with distributor, satisfactory-good repayment history (Credit Bureau Services), Satisfactory-Good Market reputation and operating business for one year.
Custody of lender/borrower funds	The Platform shall make necessary independent arrangement with "A" rated Bank through a trust account with specified terms and conditions whereby the funds of the participants of the platform shall be kept for the purpose of P2P lending and such funds cannot be withdrawn through cheque or any other means/instrument from the trust account other than API services of the platform.
Loan buyback guarantee	Platform shall provide to the lenders/investors a loan buyback guarantees to the extent of principal whereby an investor can sell loan back to the platform if repayment from the borrower is overdue as per agreed terms and conditions.

1.4 Notification of Regulatory Amendments – Caps and Limits

The regulatory framework applicable on P2P Lending was notified vide SRO 807(I)/2022 dated June 14, 2022. The framework, introduced under the Regulations, set out the eligibility requirements and the process of applying to SECP for permission to work as a P2P Service Provider. Under the framework, a lending NBFC having a valid license is eligible to apply for permission to act as P2P Service Provider subject to fulfilling certain requirements including additional equity; demonstrable technological, entrepreneurial and managerial resources; viable business plan; and a robust and secure information technology system. Furthermore, the prudential norms under the framework specify the limits for loan size, exposure to lenders, maximum investment, maturity period of loans and eligibility of lenders and borrowers.

Under the current regulatory framework, the following regulatory caps and limits are applicable on NBFCs operating as P2P Service Providers:

Table 4 –conditions and limits on P2P platforms under the NBFC Regulations

Operational Limits	Criteria
Aggregate loans taken by a borrower at any point of time, across all P2P Lending Platforms	Rs. 1 million
Exposure of Single lender to the same borrower across all P2P platforms	Rs. 500,000
Contribution by the platform in lending	Platform will contribute at least 20% in each loan
Cap on lending by a single lender across all P2P platforms	Maximum limit for: a) a single lender, who is an individual, sole proprietor, provident/gratuity fund, trust, charitable institution and section 42 company is Rs.1 Million; b) Other Lenders is Rs. 10 Million.
Maturity of loans	The maturity of loans shall not exceed 12 months
Eligibility of Lender	Lenders must be high net worth persons having net worth of at least Rs. 15 million excluding personal residence.
Custody of lender/borrower funds	The Platform shall make necessary independent arrangement with “A” rated Bank through a trust account with specified terms and conditions whereby the funds of the participants of the platform shall be kept for the purpose of P2P lending. At least two escrow accounts, one for funds received from lenders and disbursal, and the other for collections from borrowers, shall be maintained. All fund transfers shall be through bank accounts and cash transactions shall be prohibited.

1.5 Overall Performance of Pakistan’s First P2P Platform

Since its launch in January 2021, SECP has not only assessed the potential and benefits of P2P lending platforms in Pakistan, but also evaluated various risks and challenges that the platform faced. The P2P platform since its inception till February 2024 mentioned as under:

Table 5 – 3 – years performance of the platform since launch till February 2024

Description	Performance
Total No. of loans disbursed	40,932
Total No. of borrowers	7,512
Total No. of lenders	435
Total amount of loan disbursed	Rs. 1,269 million

Average amount lent	Rs. 31,010
Average annualized rate of return	21%

1.6 Innovation and Challenges

SECP is supporting Pakistan's digital lending ecosystem to cater to consumers and businesses, promoting transparency, data protection, and innovative financial solutions. To foster lending products in the digital landscape, the Commission has recently unveiled a comprehensive framework for digital lenders to launch innovative products such as embedded lending via APIs, buy now pay later services, and employer-integrated earned wage access etc. after conducting an extensive review of existing framework in collaboration with industry stakeholders. The revised guidelines aim to enhance the access to finance for Small and Medium Enterprises through Business-to-Business financing channels. Moreover, the integration of multiple NBFCs with whitelisted digital lending platforms via APIs will also facilitate the expansion of lending opportunities to a broader range of borrowers. As P2P lending platforms are more aligned with these innovations, the need to expand the horizon and outreach of P2P regulatory framework is imminent specially in the following areas:

i. Bigger ticket size loans
ii. Secure/Collateralized lending – particularly financing against moveable assets
iii. Crowd lending (debt-based crowdfunding)

Side by side, the following potential risks and challenges being faced by P2P lending platforms also need to be addressed:

i. Investor/lender protection and better credit risk assessment
ii. Prudential limits focusing on risk mitigation
iii. Enhanced protection measures over the custody of P2P platform funds
iv. Improved transparency and disclosure regime
v. Ease of understanding the risks and returns for investing in P2P platforms

2. INNOVATIVE SOLUTIONS FOR ENHANCED ACCESS TO FINANCE FOR SMEs AND GLOBAL PRINCIPLES

2.1 Pakistan's Non-Bank Lending Universe

As of the year ended June 30, 2024, a total of 85 NBFCs licensed by the SECP are providing various forms of lending services mainly around investment finance, microfinance, housing, leasing and discounting both through conventional and digital means. An analysis of the disbursement volumes and number of borrowers gathered from NBFCs through a survey conducted by SECP is presented below which highlights significant achievements in access to finance in Pakistan. The data showcases the diverse range of NBFCs operating across different modes and types of licenses, with notable contributions to both urban and rural areas. A substantial increase in financing from FY 2023 underscores the sector's role in extending financial services to underserved populations, including SMEs, MSMEs, and first-time borrowers. This expansion in lending activities is a testament to the growing confidence in NBFCs as a crucial component of Pakistan's financial system, contributing to broader economic development by enabling more individuals and businesses to access the capital they need to thrive. The sector's focus on gender inclusion, as evidenced by it's tilt towards loans disbursed to female borrowers, further highlights the NBFC sector's commitment to empowering all segments of society, thereby supporting the country's overarching goal of financial inclusion:

Table 6 – Latest NBFC sectoral data covering disbursement and inclusion (July 2023- June2024)						
Lending NBFCs	**Total Number of Loans Disbursed**	**Total Amount Disbursed Fiscal year 2024 Rs.**	**Total Amount Disbursed 2023 Rs.**	**Growth %**	**Total No. of Borrowers (first-time + old borrowers)**	**Total No. of 1st time borrowers during the year**
IFS	3,511,966	91,903,722,776	63,600,000,000	45%	543,086	297,440
NBMFCs	3,637,174	182,858,937,635	119,900,000,000	53%	2,167,932	844,419
HFCs	123	575,050,000	143,900,000	300%	112	65
Leasing	92	1,405,362,500	461,000,000	205%	75	19
Discounting	384	224,980,000	23,200,000	870%	51	37
Total	**7,149,739**	**276,968,052,911**	**184,128,100,000**		**2,711,256**	**1,141,980**

2.2 Specific Business Models

Lending products are undergoing substantial innovation, with a range of new financing solutions now available for individuals and small to medium-sized enterprises (SMEs/MSMEs). These advancements include both business-to-consumer (B2C) and business-to-business (B2B) financing options. For instance, e-commerce merchants can access specialized financing such as inventory loans and cash on delivery (COD) financing. Additionally, there are diverse product financing solutions offered, encompassing both conventional methods and Shariah-compliant modes. This evolution in lending is designed to cater to varying financial needs and preferences, supporting the growth and operational efficiency of businesses across different sectors.

The expansion of these innovative lending solutions reflects a broader trend towards more tailored financial products that address specific market demands. For SMEs/MSMEs, this means greater access to capital through flexible options that align with their operational models and growth strategies. By providing alternative financing methods, such as Shariah-compliant products alongside traditional ones, lenders are meeting the diverse needs of businesses and consumers, fostering an environment of inclusive financial support. This dynamic landscape of lending not only enhances accessibility but also promotes financial inclusion and entrepreneurship across different markets.

2.2.1 Large-Scale Leasing of Vehicles and Machinery through P2P Lending Platforms

P2P lending platforms are transforming the landscape of large-scale leasing for vehicles and machinery by providing businesses with an innovative alternative to traditional leasing arrangements. Through P2P platforms, companies can access capital directly from individual investors to lease essential equipment or vehicles needed for their operations. This direct connection often results in more competitive leasing terms, lower interest rates, and greater flexibility in repayment schedules compared to conventional leasing firms. For businesses, this means reduced upfront costs and improved cash flow management, as they can acquire necessary assets without a significant initial outlay. The P2P model also enhances transparency and efficiency, offering businesses a streamlined process for securing and managing leases, which supports their operational needs and growth ambitions.

2.2.2 Working Capital Finance and Inventory Financing for Merchants through P2P Lending Platforms

P2P lending platforms offer significant benefits for merchants seeking working capital and inventory financing. By connecting businesses directly with a network of investors, P2P platforms facilitate access to the capital needed to manage day-to-day operations and optimize inventory levels. This model provides merchants with flexible financing solutions that can be tailored to their specific needs, such as bridging gaps in cash flow or funding bulk purchases. The competitive interest rates and faster approval processes inherent to P2P lending help merchants maintain liquidity and streamline their inventory management, which can lead to better stock availability and improved sales opportunities. Additionally, the transparency and efficiency of P2P platforms can reduce the time and complexity typically associated with securing traditional loans.

2.2.3 Product Financing for Consumers through P2P Platforms

P2P platforms are enhancing product financing options for consumers by offering more accessible and affordable ways to purchase smartphones, electronic appliances, and other high-value items. By facilitating direct connections between consumers and individual investors, P2P platforms provide financing solutions that often feature lower interest rates and more flexible repayment terms than traditional credit options. This model enables consumers to acquire desired products with manageable monthly payments, making it easier to spread the cost of expensive items over time. The streamlined application process and faster approval times typical of P2P platforms further simplify the purchasing process, allowing consumers to enjoy their new products sooner and with greater financial ease. This approach not only enhances accessibility but also supports consumers in making informed and affordable purchasing decisions.

2.3 Potential Challenges to P2P scalability

P2P lending is a unique lending model where individual lend to the borrower through a platform. Considering the high-risk model as public money is being managed by an NBFC received through platform it is necessary to introduce additional measures for the risk mitigation, fund management, governance structure of the NBFC and additional provision for allowing new lending products i.e securitized lending. The following are the areas which needs further efficiency and transparency in the processes of P2P platform and governance of the NBFCs:

2.3.1 Adoption of Cybersecurity and Information Technology Standards

The implementation of advanced cybersecurity measures and adherence to industry-standard IT protocols are crucial for safeguarding sensitive data and ensuring the resilience of systems. This includes the continuous monitoring of digital infrastructure, regular security audits, and staying up-to-date with emerging threats. By adopting these standards, the organization can mitigate risks, maintain customer trust, and comply with regulatory requirements.

2.3.2 Financial Strength and Sustainability of NBFC

The financial robustness and long-term viability of the NBFC are key indicators of its ability to withstand economic fluctuations and continue operations without interruption. This encompasses strong capital reserves, prudent risk management practices, and a diversified portfolio. Ensuring financial sustainability also involves strategic planning and adapting to market dynamics to maintain profitability and growth over time.

2.3.3 Liquidity Management of the Platform

Effective liquidity management is vital for the platform to meet its short-term obligations and maintain operational stability. This involves optimizing cash flow, ensuring access to sufficient funds, and managing financial resources efficiently. By maintaining adequate liquidity, the platform can support smooth transactions, mitigate risks associated with cash shortages, and enhance investor confidence.

2.3.4 Governance Structure

A robust governance structure is essential for the effective oversight and management of the NBFC, ensuring that it operates with integrity and accountability. This includes a well-defined organizational hierarchy, clear roles and responsibilities, and adherence to corporate governance principles. A strong governance framework supports ethical decision-making, regulatory compliance, and the alignment of the company's operations with its strategic objectives.

2.4 Jurisdictional Analysis – UK and EU

International jurisdictional analysis for P2P regulatory frameworks may not serve as a fully reasonable benchmark for Pakistan due to the country's unique financial ecosystem, regulatory challenges, and socio-economic context. While global frameworks offer valuable insights, the direct application of these models might overlook local market dynamics, such as lower financial literacy rates, limited digital infrastructure, and distinct consumer behavior patterns. Furthermore, Pakistan's regulatory environment is still in its nascent stage, particularly in the fintech and P2P lending sectors, which may not align seamlessly with more mature frameworks from developed economies. However, to ensure a comprehensive understanding and to explore potential pathways for local adaptation, these frameworks have been analyzed, and the results of this analysis are mentioned in Table ‘7’. More important aspects like P2P operator’s stake in the loans and contribution limits are presented below as they are directly relevant to the challenges being discussed:

Table 7 – Jurisdiction wise comparison of P2P financial regulations

Country	Can Platforms invest in loan/securities that they facilitate	Participants' Investment Limits
Austria	The platform itself may only act in the capacity of investor under certain conditions: It is permitted If it is a minor investment, which is solely intended to facilitate the flow of information issuers between and investors, and if expressly referred to.	5,000 Euros per investor and project (within 12 months) Exception: Professional investors or legal persons, issuers who declare that their investment is limited to 10% of all their capital assets or to the double amount of their monthly income.
Belgium	Platforms can invest in Investment instruments that they commercialize, but must comply with general conflicts of interest rules.	General prospectus rules apply to crowdfunding offers: a prospectus is required for offers of 100,000 Euros or more. However, there exists crowdfunding exemption for offers below 300,000 Euros, submitted to some conditions, notably that the individual amount that each investor can invest is limited to 5,000 Euros.
France	Yes	No limit
Finland	No	IFP: 2000 Euros per loan CIP: no limit
Germany	No	If the investor has freely available assets of at least 100,000 Euros: up to 10,000 Euros in an issue. If the investor does not have freely available assets of at least 100,000 Euros: twice the investor's monthly income, but in any case not more than 10,000 Euros In all other cases (particularly if the investor does not provide a statement on assets and income): 1,000 Euros No limits for corporate entities.
UK	Yes, it is possible to operate this business model under the current regulations. But platforms need to consider conflicts of interests that may arise.	No limit
EU	Crowdfunding service providers should be prevented from having any financial participation in the crowdfunding offers on their crowdfunding platforms	Not mentioned

2.5 Jurisdictional Analysis – Asia

A comparison between Pakistan and India's existing P2P regulatory limits is tabulated below:

Table 8 – comparison between Pakistan and India's existing P2P regulatory limits

Description	Pakistan	India
Aggregate loans taken by a borrower at any point of time, across all P2P Lending Platforms	Rs. 1,000,000	₹10,00,000
Exposure of a single lender to the same borrower, across all P2P Lending Platforms	Rs. 500,000	₹50,000
Exposure of a single borrower from multiple lenders on a P2P Lending Platform (crowd lending)	Does not exist	Does not exist
Limits assigned to lenders - Individual, Sole proprietor, Section 42 company - Corporates	 Rs. 1,000,000 Rs. 10,000,000	Aggregate exposure of a lender to all borrowers at any point of time, across all P2P platforms, shall be subject to a cap of ₹50,00,000
Maturity of loans	12 months	36 months
Lenders financial standing	High net worth persons having net worth of at	Lender investing more than ₹10,00,000 across

	least Rs.15 million excluding personal residence	P2P platforms shall produce a certificate to from a practicing Chartered Accountant certifying minimum net-worth of ₹50,00,000
Prudential Limits on the P2P platform	None	NBFC shall maintain a Leverage Ratio not exceeding 2. Leverage Ratio" means the Total Outside Liabilities divided by Owned Funds, of the P2P

2.6 Securitization Structure Available under NBFC Regulatory Framework

The NBFC regulatory framework in Pakistan provides for an extensive secure lending regime. Under the NBFC Regulations, 2008, "Secured" means Exposure backed by Tangible Security [3]and any Other Form of Security with appropriate margins (in cases where margin has been specified by the Commission appropriate margin shall at least be equal to the specified margin).

In order to protect the exposure of participants on a P2P platform, secured lending may be introduced under this structure coupled with insurance where insurance protection is available for premiums below 2%. Various securitization models may be considered like P2P lending backed by tangible security with adequate insurance coverage or another option that may be considered is restricting the collateral to readily realizable or liquid assets without insurance.

2.6.1 Secured Transactions Registry

The Secured Transactions Registry (STR) is the online register established under the Financial Institutions (Secured Transactions) Act, 2016 (STA), which:

i. Financial institutions may register, amend and terminate security interests created on movable property of Entities by filing statements as per the STA.
ii. Any person may search for existing security interests on movable assets of Entities (other than companies) registered in the STR.
iii. Any person may also search the register of charges maintained under section 102 of the Companies Act, 2017.

The SECP is encouraging NBFCs engaged in securitized lending to register their charges on the Secured Transaction Registry. The benefits of utilizing a Secured Transaction Registry are include enhanced transparency by providing a clear and public record of secured transactions and making it easier to verify the existence of charges on assets. Additionally, it reduces the risk of fraud by preventing duplicate charges, thereby minimizing potential legal disputes. The registry also

[3] "Tangible Security" means Readily Realizable Assets, mortgage of land, plant, building, machinery and any other fixed assets.
"Readily Realizable Assets" include Liquid Assets and stocks pledged with the NBFCs and are in their possession, directly, or held through another NBFC or a Scheduled Bank on behalf of the NBFC, with 'perfected lien/charge duly supported with complete documentation.[3]
"Liquid Assets" means the assets which are readily convertible into cash and includes encashment or realizable value of gold, Government Securities, bank deposits, shares of listed companies which are actively traded on the stock exchange, certificates or shares of a Closed End Fund, Deposits issued by DFIs or NBFCs rated at least 'A-' by a credit rating agency registered with the Commission, Certificates of Musharika issued by Modarabas rated at least 'A' by a credit rating agency registered with the Commission, listed TFCs and Sukuks rated at least 'A' by a credit rating agency registered with the Commission and which are actively traded in the market, commercial papers rated at least 'A' by a credit rating agency registered with the Commission, National Saving Scheme securities and units of Open End Scheme for which a duly licensed Asset Management Company quotes daily offer and redemption price.[3]

improves access to credit, as lenders can more confidently assess the status of collateral, leading to more secure and efficient lending processes. Finally, it strengthens legal protection by offering certainty and a reliable framework for enforcing security interests, safeguarding the rights of secured parties.

Use of STR for secure P2P lending will greatly improve the credit environment and transparency over the collateralized assets and can help greatly with addressing potential risks related to participants' investment protection.

2.6.2 Upcoming P2P Regulatory Spheres

For achieving the scalability through P2P lending platforms and for enabling the above-mentioned product lines the SECP is considering to introduce the following option;

Securitized Lending: Securitized lending on P2P platforms offers advantages for lenders by enabling them to pool their investments into securitized assets such as vehicles, large-scale machinery, or other high-value assets. This will allow lenders to collectively fund loans backed by tangible, often revenue-generating assets, rather than individual borrowers' creditworthiness alone. By securing loans with these assets, the risk of default is mitigated compared to unsecured or clean lending, as the underlying assets can provide collateral that helps protect the lenders' investments.

Additionally, securitized lending can lead to more predictable returns and reduced exposure to borrower-specific risks, since the security of the loan is tied to the value of the asset rather than the individual's ability to repay. This mechanism not only enhances the safety and attractiveness of investments but also promotes a more stable and appealing investment environment on P2P platforms.

NBFCs offering securitized lending thorugh P2P platform has to ensure that subsequent checks are in place while processing the loan transaction i.e asset valuation mechanism, title verification, charge creation, lien perfection, insurance, borrower's covenants and loan to value ratio etc.

Crowd Lending: Crowd lending enables lenders to fund a portion of a loan rather than the entire amount, making it easier for a broader range of lenders to participate and for borrowers to access smaller, incremental amounts of capital. Both options enhance the flexibility and accessibility of funding, facilitating the growth and scalability of businesses while offering investors more diversified and manageable investment opportunities. NBFC regulatory framework in Pakistan provides for an extensive secure lending regime.

3. REGULATORY AMENDMENTS UNDER CONSIDERATION

3.1 Loan Ticket and Investment Limits

Initially, the relatively small ticket sizes in P2P lending were designed to minimize risk and encourage participation from a broad range of investors. However, as the market has shown potential and platforms refine their risk assessment models, a significant shift is required towards increasing the loan ticket sizes. The following table summarizes the limits being considered:

Table 9 –existing and proposed conditions and limits on P2P platforms under the NBFC Regulations

Description	Existing	Proposed	
		Unsecured	Secured *
Aggregate loans taken by a borrower at any point of time, across all P2P Lending Platforms	Rs. 1,000,000	Rs. 1,000,000	No limits proposed
Exposure of a single lender to the same borrower, across all P2P Lending Platforms	Rs. 500,000	Rs. 500,000	Rs. 5,000,000
Exposure of a single borrower from multiple lenders on a P2P Lending Platform (crowd lending)	Does not exist	Rs. 1,000,000	No limits proposed
Types of lenders allowed on P2P platforms	Individual Sole proprietor Provident / gratuity fund Trust Charitable institution Section 42 company Corporates	Individual Sole proprietor Section 42 company Corporates	
Limits assigned to lenders - Individual, Sole proprietor, Section 42 company - Corporates	Rs. 1,000,000 Rs. 10,000,000	Rs. 5,000,000 Rs. 50,000,000	
Maturity of loans	12 months	36 months	
Lenders financial standing	High net worth persons having net worth of at least Rs.15 million excluding personal residence	High net worth persons having net worth of at least Rs.15 million excluding personal residence. And; Individuals to participate as lender to extend credit amounting to a maximum of 10% of their net disposable income, and such net disposable income exceeds Rs. 1,200,000 per annum for the loan ticket size upto Rs. 100,000 and for the period of 12 months.	No requirement proposed

Prudential Limits on the P2P platform	None	**Option 1** Aggregate outstanding lending exposure on a P2P lending platform shall not exceed five times of the P2P Service Provider's equity **Option 2** Participants' outstanding lending exposure on a P2P lending platform shall not exceed five times of the P2P Service Provider's equity	

*** Secured means lending backed by tangible security with adequate insurance coverage that may be restricted to readily realizable or liquid assets without insurance**

a. The proposed limits on secured financing have been increased to accommodate the collateral-backed loans. This change aims to enhance the availability of credit, allowing borrowers to access larger loan amounts while providing lenders with greater security through collateral.
b. It is proposed that High Net Worth Individuals (HNWIs) requirement on secured financing may be removed. This change allow access to secured lending, to a broader range of lenders to participate in P2P platforms. NBFC will seek undertaking from HNIs/other for the risk associated with transaction.
c. Charitable institutions, gratuity funds, and provident funds manage individual's assets for long-term purposes. Due to the high risk associated with P2P lending platform, it is proposed that these entities should be excluded from participating to protect their funds from potential volatility and default.

3.2 Measures for Enhancing P2P Participants' Protection

To strengthen lender (participant) protection measures and ensuring transparency and disclosures, it is being considered that P2P shall only be offered digitally. In addition, to provide flexibility for lenders to opt out or transfer their investments to the NBFC or any other lender, compulsory disclosures for loan buy-back options and mechanism in case a lender opts to exit the P2P Lending Platform or a particular transaction shall be provided.

The SECP has recently introduced comprehensive measures around borrowers' fair treatment & protection, data/info security, IT systems etc. for digital lenders. The same set of requirements is also proposed to be made compulsory on P2P platforms.

For better risk assessment processes and onboarding of quality borrowers, increased skin in the game through higher participation of NBFC in P2P transactions is being considered. NBFCs will be required to contribute at least 20% (existing requirement 15%) in each loan disbursed through the platform provided that the agreed loan contribution shall stand at par in rights, terms of recovery and repayment to lenders. Further, the Minimum Equity Requirement for NBFCs to operate P2P platforms is also being considered to be increased to Rs. 150 million.

Non-High net worth individual participants to be allowed as lender subject to the specified income and threshold.

3.3 Measures for Strengthening Governance Structure and Credit Rating Requirements for NBFCs

Introducing a credit rating requirement for peer-to-peer (P2P) lending platforms can enhance trust and transparency, helping both lenders and borrowers make more informed decisions. Additionally, credit ratings can attract more institutional investors, boosting overall market growth. It is proposed that credit rating NBFCs operating P2P platform shall not be lower than minimum investment grade i.e. BBB (plus).

To ensure the efficient governance structure it is also proposed that the requirement of number of directors for NBFCs operating P2P shall not be less than five.

3.4 Other Regulatory Amendments Under Consideration

A holistic review of the NBFC Regulations, 2008 has been undertaken to consider the effectiveness of existing regulations and the need to modify the regulatory framework or adopt new requirements in light of new market developments, market feedback (including two quarterly Microfinance Coordination Forum sessions) and outcomes from supervision activities during the previous 1-2 years. The scope of review also includes identifying and removing redundancies for ease of navigation through the regulations.

The following amendments are proposed to account for the inflationary impact on loan ticket sizes and to align the definition of SMEs/MSMEs with other stakeholders. As the reach of digital fintech services expand access to the masses, it is essential to introduce consumer protection measures, including an effective grievance redressal system. Additionally, to support the adoption of new digital lending products, clear definitions have been provided, ensuring alignment with practices in other international jurisdictions.

a. <u>Liberalization of NBFC regulatory regime</u>

i. Removal of employee head count requirement from definition of small enterprise and medium enterprise
ii. Limit of unsecured finance by deposit taking NBFCs increased from Rs. 200,000 to Rs. 500,000
iii. Increasing the loan ticket size upto Rs. 3,000,000 for housing finance by HFC and microenterprise loans given by non-banking microfinance companies.

b. <u>Ease of Doing Business</u>

i. Revision of the fit and proper criteria to facilitate tech entrepreneur's entry into the licensed fintech space under the NBFC framework.
ii. Introducing the simplified borrower's fact sheet for the digital lenders.

c. <u>Enhanced consumer protection measures</u>

i. For sector wide improved credit behavior reporting and adequate data availability, all lending NBFCs to obtain membership and report data to all private CIBs
ii. Digital lending NBFCs to report credit data to all CIBs on a real time basis
iii. All lending NBFCs to comply with Grievance Redressal System guidelines and report to the Commission the information specified in the guidelines

d. <u>Introduction of new financing product lines, enabling Sharia governance framework & requirement of one female independent director for Non-Bank Microfinance Companies</u>

i. Definition of Consumer Finance expanded to include:
   a. Buy Now Pay Later arrangement
   b. Earned wage access
   c. Nano Lending
   d. Education finance
   e. Advance against salary

ii. Enabling Shariah Governance Framework through:
   a. introduction of Shariah Advisor definition in line with Shariah Governance Regulations, 2023
   b. Requirement to appoint Shariah Advisor introduced for lending NBFCs which intend to conduct Shariah compliant business
   c. Requirement to obtain shariah compliance certificate for shariah compliant products

iii. Mandatory female independent director on the board of Non-Bank Microfinance Companies:

   a. Female representation on boards is linked to the creation of more balanced and inclusive policies, especially in the microfinance sector, where women represent a significant share of the client base. The inclusion of a female independent director can significantly strengthen the development of gender-focused strategies, enabling the company to more effectively meet the unique needs and challenges faced by female clients. This inclusion will foster equity and enhance business outcomes by ensuring that policies are thoughtfully designed through a gender lens.

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