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Islamic Republic of Pakistan  
Diagnostic Review of  
Consumer Protection and  
Financial Literacy

Volume I  
Key Findings and  
Recommendations



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**Islamic Republic of Pakistan**

*Diagnostic Review of  
Consumer Protection and  
Financial Literacy*

**Volume I**

**Key Findings and Recommendations**

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<sup>1</sup> The CPFL Review is part of the World Bank Program on Consumer Protection and Financial Literacy, which seeks to identify key measures in strengthening financial consumer protection to help build consumer trust in the financial sector—and expand the confidence of households to wisely use financial services. CPFL Reviews against Good Practices have been conducted by the World Bank in both middle- and low-income countries. These include Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Kazakhstan, Latvia, Lithuania, Malawi, Mongolia, Mozambique, Nicaragua, Romania, the Russian Federation, the Slovak Republic, South Africa, Tajikistan, and Ukraine.

**Islamic Republic of Pakistan**

**Diagnostic Review of Consumer Protection and  
Financial Literacy**

**Volume I – Key Findings and Recommendations**

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## Acronyms

ATM	Automated teller machine
BCO	Banking Companies Ordinance
BMP	Banking Ombudsman Pakistan
CCP	Competition Commission of Pakistan
CPD	Consumer Protection Department
CPFL	Consumer Protection and Financial Literacy
DFI	Development Finance Institutions
DFID	Department for International Development
GoP	Government of Pakistan
IAP	Insurance Association of Pakistan
ICM	Institute of Capital Markets
IEAP	Investor Education and Awareness Program
IO	Insurance Ombudsman
ISE	Islamabad Stock Exchange
KFS	Key Facts Statements
KSE	Karachi Stock Exchange
LSE	Lahore Stock Exchange
MFB	Microfinance banks
MFI	Microfinance institutions
MoF	Ministry of Finance
MOU	Memorandum of Understanding
MUFAP	Mutual Funds Association of Pakistan
NBFI	Non-bank financial institutions
NFLP	Nationwide Financial Literacy Program

OBM	Office of the Banking Mohtasib
PBA	Pakistan Banks' Association
PII	Pakistan Insurance Institute
PMN	Pakistan Microfinance Network
PPAF	Pakistan Poverty Alleviation Fund
PRCF	Prudential Regulations for Consumer Financing
PRMFB	Prudential Regulations for Microfinance Banks
PSIA	Profit sharing investment account
SBP	State Bank of Pakistan
SECP	Securities and Exchange Commission of Pakistan
SME	Small and medium enterprise
SRO	Self-regulatory organization



## Consumer Protection and Financial Literacy in Pakistan

### Volume I

#### I. Executive Summary

**1. The Diagnostic Review for Consumer Protection and Financial Literacy (CPFL) provides a detailed assessment of the institutional, legal, and regulatory framework in four segments of the financial sector: banking, microfinance, securities, and insurance.** The review took place in response to a request for World Bank technical assistance in the field of financial consumer protection made by Pakistan’s Ministry of Finance (MoF), the State Bank of Pakistan (SBP), and the Securities and Exchange Commission of Pakistan (SECP).

**2. The Review consists of two volumes.** Volume I summarizes the key findings and recommendations of the Review and Volume II presents a detailed assessment of each financial segment compared against the Good Practices for Financial Consumer Protection.<sup>2</sup> The key findings and recommendations in Volume I cover five areas: (i) The Institutional, Legal, and Regulatory Framework for Consumer Protection; (ii) Disclosure; (iii) Business Practices; (iv) Dispute Resolution Mechanisms; and (v) Financial Education. Priority recommendations are outlined in table 1; a more detailed list of recommendations is included in annex I.

**3. Pakistan’s financial regulators have taken important steps to strengthen consumer protection and financial education in recent years.** SBP, using its broad powers to protect the public interest and the interest of depositors, has issued regulations and directives to banks covering key aspects of consumer protection, including disclosure, business conduct, and dispute resolution. It has also laid out an ambitious agenda for further strengthening consumer protection in its “10-Year Strategy for the Banking Sector Reforms,” which is well aligned with international good practices. SECP has a strong statutory mandate to protect investor and consumer rights and interests in the insurance and securities sectors, but needs to step up its supervisory and enforcement capacity to deal with noncompliance and malpractices in both market segments.

**4. The institutional framework for financial consumer protection in Pakistan is fragmented, and has important gaps and overlaps.** The two principal financial regulators, SBP and SECP, have primary responsibility for regulating and supervising both prudential matters and market conduct in their respective market segments. Non-deposit-taking microfinance institutions (MFIs) are unregulated, leaving many clients vulnerable from a consumer protection standpoint. A number of other players, however, have a role in ensuring financial consumer protection, including the Competition Commission of Pakistan (CCP), industry associations, ombudsmen, and provincial consumer protection councils. There is a need to establish an effective coordination mechanism among regulators and key stakeholders, to define strategic priorities and clarify roles and responsibilities.

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<sup>2</sup> The Good Practices for Financial Consumer Protection were developed by the World Bank in 2006 and launched globally in 2010. They provide a set of good practices using international benchmarks, such as the principles released by the Basel Committee, IOSCO, and IAIS, as well as the OECD recommendations for financial education and awareness on pensions, insurance, and credit products. The Good Practices incorporate provisions of directives, laws, regulations, and codes of business practices from the European Union, United States, Australia, Canada, France, Ireland, Malaysia, Mexico, New Zealand, Peru, and South Africa. The Good Practices are used in assessing a country’s financial consumer protection regime. Consumer Protection and Financial Literacy Reviews against Good Practices have been conducted by the World Bank in both middle- and low-income countries. These include Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Kazakhstan, Latvia, Lithuania, Malawi, Mongolia, Mozambique, Nicaragua, Romania, the Russian Federation, the Slovak Republic, South Africa, Tajikistan, Ukraine, and Zambia.

- 5. Although financial regulators have strengthened disclosure requirements, terms and pricing often remain nontransparent in practice.** The lack of standardized, comparable pricing information on financial products impedes competition in the financial sector and no doubt contributes to the relatively high costs of financial products and services in Pakistan.
- 6. There is a need to establish and monitor appropriate industry Codes of Conduct across the financial sector, and to require appropriate training and certification of market intermediaries.** Most industry segments do not have Codes of Conduct in place to commit financial institutions to fairness, transparency, and ethical conduct. Such codes should be established by relevant industry associations in cooperation with regulators, and compliance with the codes should be monitored. There is also a need to ensure that market intermediaries who deal with clients, such as insurance agents and securities brokers, are properly trained and certified.
- 7. Effective and speedy alternative dispute resolution mechanisms are particularly important in Pakistan, where courts cannot be relied on to provide timely, affordable, and predictable redress to consumers.** Generally sound grievance and redress mechanisms exist for bank customers, but their effectiveness could be enhanced by increasing awareness of the process and streamlining procedures. Awareness of the insurance ombudsman is low, and there is no equivalent in place for resolving disputes for retail customers in the securities market or for microfinance clients. These gaps should be addressed, either by the financial sector itself or through the establishment of a common financial ombudsman. Finally, comprehensive complaints data should be collected, analyzed, and published, with a view to identifying major issues and informing CPFL policy.
- 8. SBP and SECP have recognized the importance of financial education and have initiated programs to address gaps.** SBP, in partnership with the Pakistan Poverty Alleviation Fund (PPAF) and Pakistan Microfinance Network (PMN), has developed a Nationwide Financial Literacy Program (NFLP) aimed at low-income people. SECP is implementing a comprehensive investor education program and is currently drafting recommendations for insurance education and awareness campaigns. As a next step, the authorities may wish to consider developing an integrated financial education strategy based on a national financial capability survey, ensuring close coordination among all relevant stakeholders, and securing high-level government support, which is critical for these initiatives to succeed.

### *Key Preliminary Recommendations*

A list of key recommendations is found below:<sup>3</sup>

<i>Recommendations</i>	<i>Responsible Organization</i>	<i>Term<sup>4</sup></i>	<i>Priority</i>
Establish an effective coordination mechanism for financial consumer protection among regulators and key stakeholders. Define joint priorities and clarify roles and responsibilities. Clarify supervisory roles and responsibilities for each step of the effective delivery of financial products, and in instances where multiple regulators are involved (e.g., bancassurance), determine which regulator has the lead role.	<b>SBP</b> , SECP, CCP, industry associations, ombudsmen, provincial consumer protection councils, etc.	ST	High
Strengthen SECP's risk-based supervisory and enforcement capacity to deal with noncompliance and malpractices in the insurance and securities sectors. Require minimum qualifications and certification of brokers and agents, and apply fit and proper criteria on corporate brokerage firms.	SECP	LT	High
Strengthen disclosure by requiring (i) standardized methodologies to calculate and disclose total costs or returns; (ii) minimum contents of terms and conditions; (iii) Key Facts Statements (KFS); and (iv) cooling-off periods for relevant products.	SBP, SECP, PMN, PPAF, PBA, MUFAP, IAP	MT	High
Assess and implement suitable and pragmatic institutional arrangements to address existing gaps in nonbank microfinance consumer protection, and extend basic minimum standards to MFIs.	PMN, PPAF, SBP, SECP	S/MT	High
Strengthen dispute resolution mechanisms by (i) setting minimum standards for internal complaints handling at all financial institutions; (ii) establishing effective, speedy, and low-cost alternative dispute resolution mechanisms for securities, insurance, and MFIs and MFBS, or consider a single financial ombudsman; (iii) centralizing, analyzing, and publishing data on consumer complaints in all sectors to use in formulating CP policies; and (iv) increasing consumer awareness of redress mechanisms.	SECP, KSE, ISE, LSE, MUFAP, PBA, PMN, PPAF	MT	High
Develop an integrated financial education strategy, based on a Financial Capability Survey.	SBP, SECP, industry associations, Ministry of Education	MT	High

More detailed recommendations are included in the body of this report and in annex I.

<sup>3</sup> In bold, suggested institution to assume a lead role.

<sup>4</sup> ST, short term, indicates action can be undertaken in zero to six months. MT, medium term, indicates six months to one year. LT, long term, indicates more than one year.

## II. Country Context

**9. CPFL is key to increasing responsible access to financial services in Pakistan.** Pakistan's financial system is overwhelmingly dominated by banks, which hold approximately 74 percent of financial system assets, a level that has remained fairly constant over the past decade. National savings—a government-sponsored retail savings scheme—represents 17 percent of system assets, while insurance and other non-bank financial institutions hold less than 10 percent of system assets. The rapid growth in household lending in Pakistan over the past decade has been accompanied by an increase in the number of households that have taken on risks and obligations that they do not fully understand—at times a result of unfair or deceptive practices. Strong financial consumer protection can empower the public to demand improved transparency and efficiency in the financial sector by ensuring that households, individuals, and firms have access to clear and transparent information about costs, risks, and rewards of financial products. Financial literacy gives consumers the tools needed to make prudent financial decisions, and to understand recourse options if disputes arise. Together, consumer protection and financial literacy build public confidence in financial institutions, thus encouraging savings and long-term financial investments that promote financial deepening.

**10. The level of financial exclusion in Pakistan is high.** According to the 2008 FinScope survey 56 percent of the adult population was financially excluded and used neither formal nor informal financial products. Further, 71 percent of respondents thought that they could easily live their life without a bank account, and only 56 percent of the adult population saved; only 3 percent of these were formal savers. Only 2 percent of people had a formal insurance policy, and just 3 percent understood what was meant by mobile banking and mobile phone banking. According to the World Bank's Global Financial Inclusion Database,<sup>5</sup> as of 2011 only 10 percent of the population age 15 and older had an account at a formal financial institution, compared with the South Asian regional average of 33 percent. In this same population, only 2 percent had obtained a loan from a financial institution in the previous year, while 23 percent obtained such loan from informal sources (family or friends), compared with South Asia regional averages of 9 percent and 23 percent, respectively. Finally, basic literacy—which is relevant because some awareness techniques may require reading skills—remains at a low 54.9 percent of the population. Such dire statistics amplify the need to reach potential consumers with structured and targeted programs to increase their understanding of financial services.

**11. CPFL can also play an important role in ensuring prudent growth of credit markets.** While access to financial services has been expanding, credit growth and portfolio quality have been volatile. Bank penetration and deposit mobilization have been growing rapidly, but bank lending to the private sector has stagnated following a period of rapid growth. A rapid rise in lending to previously underserved markets (notably small and medium enterprises and consumers) in the early 2000s was followed by a sharp deterioration in portfolio quality, because both banks and consumers had limited experience in these markets, and consumer protection, financial literacy, and credit information were poor. Consumer lending, which had been negligible before the late 1990s, was the fastest-growing segment of the credit market from the late 1990s through 2008, when it reached 18 percent of total lending. The rapid rise in NPLs led to a sharp reversal in this trend, with some banks withdrawing entirely from this market. From December 2008 to September 2012, the share of consumer lending dropped from 18 percent to just 6 percent.

**12. Several laudable initiatives are under way to promote both greater financial inclusion and improved financial education. Financial education is an important step in increasing inclusion and responsible access to financial services.** The authorities have recognized that ongoing financial inclusion programs need to be accompanied by enhanced efforts to improve financial literacy, because they are targeted at

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<sup>5</sup> [http://data.worldbank.org/data-catalog/financial\\_inclusion](http://data.worldbank.org/data-catalog/financial_inclusion).

individuals and firms who have little experience in dealing with financial service providers. The landscape for financial services is also undergoing some significant changes, with the introduction of new products and services—such as mobile banking, crop and health insurance, and microinsurance—which also leads to an increased need for financial education. SBP is undertaking a pilot financial literacy program, with the ultimate objective of rolling it out nationally. The results and recommendations of this diagnostic may assist regulators and the government in formulating appropriate policies to strengthen consumer protection and financial literacy in Pakistan.

### III. The Legal, Institutional, and Regulatory Framework for Consumer Protection in Pakistan

#### *Key Findings*

**13. The institutional framework for financial consumer protection in Pakistan is fragmented, and has important gaps and overlaps.** Although the MoF is in charge of overall financial sector policy and development issues, it does not deal directly with financial consumer protection matters. There are two main financial supervisory agencies in Pakistan: SBP, which regulates commercial banks, development finance institutions (DFIs), microfinance banks (MFBs), and exchange companies; and SECP, which regulates and supervises the other sectors of the financial system, including the securities and insurance markets. In addition, the CCP, an independent quasi-regulatory, quasi-judicial body has a mandate to, among other things, protect consumers from anti-competitive practices and deceptive marketing practices. The CCP has investigated and has imposed penalties on financial service providers in matters that pertain to financial consumer protection, such as alleged price fixing of specified interest rates or ATM fees. There are two independent, statutory ombudsmen to resolve disputes between consumers and financial institutions, the Office of the Banking Mohtasib (OBM) and the insurance ombudsman (IO). The three stock exchanges have a frontline role in regulating certain activities of the exchanges, including matters that directly affect individual investors, and they require that disputes involving their members be arbitrated under their regulations.

**14. The legal framework does not provide clear consumer protection rules over financial products and services.** Pakistan's constitution refers to a Federal Legislative List, which governs the division of legislative powers between the federal government and provinces. All matters that do not appear on the federal list are devolved to the provinces. Banking and financial services are on the federal list, whereas consumer protection is deemed to be a provincial matter. All provinces except Sindh have provincial consumer protection acts<sup>6</sup> that cover both goods and services. However, with the exception of the province of Punjab, these laws are not yet fully operational. Punjab has established consumer protection councils and courts under their consumer protection act, and reports that it has dealt with some 700 cases involving financial services. Under Pakistan's legal system, specialized laws are deemed to have precedence over general laws, so most observers believe that federal laws governing banking and other financial services that include protection of the public and investors would take precedence over the more general provincial consumer protection laws. SECP has a strong statutory mandate to protect investor/consumer rights and interests, and the draft Securities and Exchange Commission of Pakistan (Regulation and Enforcement) Bill currently before parliament is set to further strengthen its powers and enforcement. SBP implements its consumer protection function pursuant to its general powers to protect the public interest and the interest of depositors.

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<sup>6</sup> See, for example, the Punjab Consumer Protection Act 2005.



**15. SBP has primary responsibility for consumer protection issues in commercial banks, DFIs, MFBs, and exchange companies.** It derives its powers principally from the SBP Act, 1956; the Banking Companies Ordinance (BCO), 1962; and the MFB Ordinance. None of these laws gives SBP an explicit consumer protection mandate, but they do provide broad powers to SBP to, among other things, develop rules, regulations, and directions, when it is satisfied that it is “(a) in the public interest; or (b) to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or (c) to secure the proper management of any banking company generally.” Financial institutions regulated under these laws are legally bound to comply with such directions. SBP’s powers and the binding nature of its directions on regulated entities have been demonstrated in practice and upheld by the Supreme Court. SBP has used these powers extensively to issue secondary legislation, including rules, regulations, and other directives on consumer protection matters in recent years. It has established a Consumer Protection Department (CPD), to deal primarily with consumer disputes,<sup>7</sup> while SBP’s Inspection Department verifies compliance with consumer protection rules, regulations, and other directives during annual onsite inspections. SBP has the authority to impose sanctions, including fines, on banks that fail to comply with consumer protection directives.

**16. SBP has issued fairly comprehensive regulations and directives to strengthen consumer protection in recent years.** It has enacted Prudential Regulations for Consumer Financing (updated June 2011), which regulate a number of important issues pertaining to market conduct and consumer protection, and has issued numerous relevant circulars. These cover the key areas arising from consumer financing, including disclosure standards, business conduct, underwriting standards, complaints, cooling-off periods, sale of third-party products, fair debt collection, pricing, and loan documentation. SBP has also laid out an ambitious agenda for strengthening consumer protection in its “10-Year Strategy for the Banking Sector Reforms.” The recommendations outlined in this report are generally well aligned with SBP’s own vision and strategy for enhancing financial consumer protection.

**17. The legal and institutional arrangements for consumer protection in microfinance are highly fragmented.** Microfinance service providers adopt a variety of legal forms under various federal and provincial laws. Only MFBs are regulated by a statutory body with enforcement powers (SBP), while non-deposit-taking microfinance institutions are left unregulated. There is limited coordination among agencies, resulting in regulatory gaps, a vacuum in redress mechanisms, even a lack of official statistics about the total number of MFIs, and little awareness of consumer protection in the industry. There have been discussions about bringing regulation of MFIs under SECP, but it is not clear that this would be the best solution, given SECP’s limited resources and expertise in the area, and the fact that many of the largest MFIs are transforming into MFBs, which will bring them under the scope of SBP.

**18. The fragmented legal environment, particularly as it pertains to consumer protection, does not provide a sound basis for the microfinance industry’s long-term sustainability.** It also puts at risk the progress achieved so far under what is considered one of the world’s more progressive regulatory environments for microfinance. There is evidence of poor practices, including ineffective redress mechanisms, discriminatory lending policies against women, poor client monitoring and underwriting procedures allowing loans to be passed on to people other than the borrower, inadequate price disclosure, and abusive loan collection. The experiences of other countries have highlighted the risks of postponing serious measures on consumer protection until grievances reach the media and invite political interference. The current laws leave MFIs, which cater to the majority of microfinance borrowers, largely uncovered from a consumer protection standpoint.

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<sup>7</sup> The Federal Ombudsmen Institutional Reforms Act, 2013, which was promulgated subsequent to the CPFL mission, may have implications for CPD. Some concerns raised by CPD in this regard are highlighted in box 1.

**19. Overall, the regulatory framework for consumer protection in MFBs is clear, but more detailed regulations would be desirable.** None of the requirements in the MFB Ordinance or the Prudential Regulations for Microfinance Banks (PRMFB) are detailed enough to ensure consistency of practices across MFBs. The PRMFB do not set standards for matters such as systems that handle MFB complaints (although it seems that in practice SBP requires MFBs to at least have means to address consumer complaints), disclosure formats to facilitate price comparison, and prohibition of unfair, deceptive, discriminatory practices.

**20. The legal and regulatory frameworks for branchless banking are relatively robust for consumer risks, but again MFI clients remain unprotected.** There have been instances of agent fraud and abuse (e.g., overcharging of fees) and other problems with electronic and agent transactions, but the industry is in its infancy, and the lack of information on consumer complaints makes it difficult to assess the performance of branchless banking at the consumer level. As branchless banking takes off in Pakistan, it is important to monitor consumer issues. Only banks and MFBs can operate branchless banking platforms and agent networks, but MFIs use their services without having to follow any consumer protection standard such as data privacy.

**21. Depositor protection is ambiguous in Pakistan.** Under the Banks (Nationalization) Act of 1974, all bank deposits are protected by government. This provision was introduced when the banks were nationalized, and is no longer appropriate in a system that is largely privately owned. It is also not clear that the government of Pakistan would be in a position to honor this guarantee in a timely and orderly manner if one or more large banks failed. A draft law establishing an explicit deposit protection scheme to provide protection to small depositors was drafted some time ago, but has not been submitted to parliament.

**22. SECP has a strong legal mandate to protect the rights and interests of investors in the securities sector.** The Securities and Exchange Commission of Pakistan Act (SECP Act), 1997, vests SECP with an explicit mandate to resolve complaints between securities brokers and their clients. In addition, the act provides a strong mandate for SECP to “strive to maintain confidence of investors in the securities markets by ensuring adequate protection for such investors” in the performance of its functions pursuant to SECP Act. SECP has also issued the Broker and Agents Registration Rules, 2001, which requires brokers who fail to resolve an investor’s complaint to be liable for suspension and ineligible for registration/licensing by SECP. SECP receives complaints from investors and directs them to the different operations within SECP according to the subject matter, and has recently established a centralized unit to monitor complaints. It also publishes statistics on the nature and number of complaints and their status in its annual reports, though the statistics are insufficiently detailed to assist in the identification and analysis of key trends and issues.

**23. However, the legal framework does not adequately provide SECP with a range of options to ensure effective enforcement, which is integral to strengthening investor protection.** For example, the current legal framework does not allow SECP to take action to freeze the assets of, or enjoin violations of the law by, unlicensed entities, even though SECP may request SBP do so on its behalf. In addition, its enforcement options today are limited to issuing prohibitory orders, issuing directives, and imposing fines. SECP does not have power to seek damages on behalf of investors and compensate them in the event of abusive market conduct or other forms of misconduct in business dealings. Two primary pieces of legislation submitted by SECP to the government of Pakistan—the Securities and Exchange Commission of Pakistan (Regulation and Enforcement) Bill and the Securities Bill—have provisions that would substantially increase its supervisory and enforcement powers.

**24. Similarly, the 2000 Insurance Ordinance provides an explicit mandate for SECP to protect insurance policyholders, but further efforts are required to effectively fulfill this mandate.** This is the primary statute governing the insurance industry, and the preamble states: “To regulate the business of the insurance industry to ensure the protection of the interests of insurance policy holders and to promote sound

development of the insurance industry.” However, although SECP has considerable statutory powers to regulate and supervise insurers and intermediaries, it has not always used these powers effectively to supervise and enforce adequate consumer protection standards in the industry. To date, SECP has focused its regulatory and supervisory efforts more on prudential supervision than consumer protection. Recent initiatives to promote microinsurance have heightened the importance of consumer protection in the insurance industry. There is also a need to clarify the roles and responsibilities of the federal government (Ministry of Commerce) and SECP with respect to subsidiary legislation.

**25. In Pakistan, where demutualized stock exchanges are profit-oriented, it is critical for the self-regulatory organization (SRO) system to be sound, with a strong oversight framework to be implemented by SECP.** This should be underpinned by explicit provisions in the law or rules. Hence, the front-line responsibility of the demutualized exchanges would need to be strengthened on a risk-based basis and a new framework established for SECP’s oversight over listed exchanges. The Securities and Exchange Commission of Pakistan (Regulation and Enforcement) Bill and the Securities Bill have specific provisions relating to registration and regulation of SROs but the laws are pending approval by the parliament.

### *Recommendations*

**26. Because of the fragmented nature of financial consumer protection, a mechanism is needed to provide for effective coordination among all relevant stakeholders.** Consideration could be given to the establishment of a Financial Consumer Protection Task Force, comprising SBP, SECP, CCP, ombudsmen, industry associations, provincial Consumer Protection Councils, as well as interested consumer associations to introduce a more strategic perspective on financial consumer protection, and define issues and propose solutions, including proposed legal and regulatory changes. One agency should be given the mandate to lead and coordinate this effort. It would be particularly important for the principal financial regulators, SBP and SECP, to coordinate more closely given ownership linkages among banks and nonbanks and the fact that banks often serve as a distribution channel for insurance and asset management products. Working groups could be formed with other stakeholders to work on specific aspects of CPFL.

**27. The legal framework for financial consumer protection would benefit from greater strength and clarity, along with consistent enforcement of existing provisions.** There are several ways to create greater clarity in the legal framework for CPFL. One would be to introduce a Financial Consumer Protection Act at the federal level, which would cover a range of issues, including transparency, confidentiality, availability of statements, data protection, account servicing, protection against unfair contracts and lending practices, and so forth. A new Consumer Protection Act was in fact proposed in SBP’s 10-Year Strategy Paper. Another option would be to introduce a new Banking Act or amendment to the BCO, 1962, and the Microfinance Bank Ordinance to give SBP an explicit consumer protection mandate. In practice, however, passing major new financial legislation in Pakistan has proven to be a very difficult and protracted process, and SBP has effectively used its broad powers to introduce and enforce consumer protection measures through secondary legislation and directives. In addition to the legal mandate, it is important that the regulators have adequate capacity to enforce and monitor their expanded CPFL mandate. To this end, it is recommended that SBP and SECP undertake institutional self-assessments to identify any gaps.

**28. SBP may also wish to consider better delineating the internal roles and responsibilities of various departments in CPFL.** The CPD receives consumer complaints from clients of both scheduled banks and microfinance banks, which it may handle directly or pass on to the OBM or Department of Agricultural Credit

and Microfinance at SBP, which also handle consumer complaints from scheduled banks and microfinance banks, respectively. It would appear that there is overlap and a lack of clarity in the responsibility for handling consumer complaints within SBP, and that the role of the CPD is not clearly defined. One option would be to give the CPD a broader research and policy role in CPFL in all market segments that fall under SBP's jurisdiction.

**29. A pragmatic strategy to address the legal and regulatory gaps for MFIs needs to be designed and implemented.** This could include a range of non-regulatory actions that could be implemented by the PMN and PPAF, with strong support from SBP. MFIs should continue to be encouraged to register with SECP under Section 42 of the Companies Ordinance, and SECP should publish a central register of all microfinance providers in operation in Pakistan, with their main characteristics. Consumer protection risks in branchless banking should be addressed by setting and monitoring compliance, with standards similar to those applicable to MFBs.

**30. The regulators should put in place appropriate consumer protection regulations and supervision processes to deal with new and emerging distribution channels.** For example, branchless banking and insurance regulations may need to be amended to ensure that disclosure, fair treatment, and recourse standards apply when third parties or electronic devices are used for service delivery. The regulators may also wish to carefully review complaint reports to identify any industry-wide problems in branchless banking or other new distribution channels.

**31. There is a need to clarify the position on depositor protection through appropriate legislation.** The proposal outlined in SBP's "10-Year Strategy Paper" for creating a deposit protection scheme would appear to be an appropriate solution for Pakistan. A deposit insurance system should limit the scope for discretionary decisions, promote public confidence, help contain the costs of resolving failed banks, and provide for an orderly process for dealing with bank failures. The law should specify how the system is to be funded on a sustainable basis, as well as its obligations to depositors, and must be part of a well-constructed financial system safety net. It would need to be supported by a high level of public awareness about its existence, benefits, and limitations.

**32. There is a need to strengthen SECP's risk-based supervisory and enforcement capacity to deal with noncompliance and malpractices in the insurance and securities sectors.** In addition, brokers and agents should be required to hold minimum qualifications and should be certified, and corporate brokerage firms should be subject to fit and proper criteria. The new Broker Rules being developed by SECP cover these aspects. SECP should exercise its powers to undertake a more comprehensive program of onsite inspections of both private and state-owned insurers, including microinsurance providers.

## IV. Consumer Disclosure

### *Key Findings*

**33. Both SBP and SECP have issued directives to financial institutions to enhance transparency and disclosure of their terms and conditions, but in practice the terms and pricing often remain nontransparent.** The lack of standardized, comparable pricing information on financial products impedes competition in the sector and no doubt contributes to the relatively high banking spreads and fees in Pakistan. Currently financial institutions do not provide a standardized summary statement, such as a Key Facts Statement (KFS), that would allow consumers to compare offers from different providers. The KFS could also constitute an efficient way to inform consumers about their basic rights, credit reporting systems, and grievance procedures. Moreover, although current prudential regulations prescribe that banks, MFBs, securities intermediaries, and others clearly and transparently show all costs, there is no standard format or methodology of calculation of all-in

costs or returns. In practice, the quality of the information provided to consumers appears to vary widely across the industry, and there is limited analysis, at the industry level, of disclosure practices and how well they work.

**34. Inadequate disclosure by insurance companies has contributed to their poor reputation among the public and has hindered development of the market.** The Insurance Ordinance requires the insurer or an insurance intermediary to use plain language when drafting policy documentation, but there are no standard templates to provide clear information to policyholders.

**35. Islamic banking products also require enhanced disclosure requirements.** A 2009 survey by Hawkamah indicated that disclosure and transparency for Islamic products for retail investors need substantial strengthening.

**36. The poor operation of Pakistan’s postal service makes it difficult and costly to deliver regular statements to customers.** Good practice requires monthly statements for all bank customers, for example, but in Pakistan banks are required to send statements only every six months. This periodicity is inadequate, but banks indicated they have to use costly private courier services to deliver statements, and the cost of more frequent delivery would be prohibitive, particularly for small clients. As elsewhere, banks in Pakistan are shifting to technology (Internet and e-mail) to deliver statements wherever possible, but not all customers have access to these channels. Some banks notify customers of transactions and balances by text messages through cell phones.

### *Recommendations*

**37. SBP and SECP should require financial institutions to provide Key Facts Statements for all basic consumer finance products,<sup>8</sup> should regulate the minimum content of terms and conditions, and should require that they be written in easily understood language.** Banks should further be required to disclose a standardized effective mark-up to use in all advertising, marketing, and sales materials.<sup>9</sup> In insurance, SECP should introduce common templates to provide clear, understandable, timely, and standardized information to policyholders. Industry associations should consider undertaking consumer testing of KFSs before they are introduced to ensure that they are well understood. The availability of information in Urdu as well as other local languages should be encouraged, and customer surveys should be undertaken to test consumer understanding of the disclosure formats. In cooperation with industry associations, the regulators should consider how best to provide more frequent information to consumers through alternative channels, given the unreliability of the postal service. More frequent statements could be made available to customers, free of charge, at branches or ATMs, for example. Supervisory capacity should be strengthened to enhance enforcement of the improved disclosure rules, including by microfinance providers.

**38. Consideration should be given to establishing a website for comparing prices of standard financial products, with complementary dissemination mechanisms for those without Internet access.** The sponsor of such a website would need to be considered trustworthy by the public. The website could also include easy-to-use financial tools, to compare similar products or to plan for expenditures. National price comparison websites have increased competition and reduced consumer prices on financial products and services in a number of markets

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<sup>8</sup> There are several relevant examples of key facts statements that SBP may wish to review, such as the U.K. Financial Services Authority’s (initial disclosure documents applicable to housing credit products; the European Union’s Standard European Consumer Credit Information form; the U.S. Truth in Lending Act’s “Schumer Box” for credit cards; Peru’s “HojaResumen” (Summary Sheet); South Africa’s Pre-Agreement Statement & Quotation for Small Credit Agreements; and Ghana’s Pre-Agreement Truth in Lending Disclosure Statement.

<sup>9</sup> For example, Peru’s Regulation of Transparency requires banks to disclose the “TCEA,” or annual effective cost rate, which is expressed as an interest rate, but includes all costs associated with a consumer credit.



around the world. If professional or consumer associations do not establish such websites, the regulators (SBP/SECP or CCP) may wish to take the lead on this.

**39. In relation to Islamic products, such as savings mobilized under the Muḍârabah principle and profit sharing investment accounts (PSIAs), SBP may wish to enhance transparency and accountability by requiring** that (i) banks should publish and explain their approach to Shariah compliance, and the banks' governance structure for ensuring Shariah compliance; and (ii) the profit and loss sharing accounts and PSIA terms and conditions should be transparent, concise, and written to be easily understood by the typical investor. Information that should be disclosed includes (i) the rights and liabilities of both parties, notably with respect to circumstances where losses are to be borne by the investor, and the investor's contractual rights with regard to early withdrawal or redemption; and (ii) the bank's responsibility to disclose accurate, relevant, and timely information to the investor on the investment of the PSIA, including its performance, investment policies, and valuation.

## V. Business Practices

### *Key Findings*

**40. Not all segments of the financial sector have principles-based Codes of Conduct that bind financial service providers to established standards of service and quality.** SBP has encouraged the Pakistan Bankers Association to adopt a business code of ethics to be used as a basis for committing all banks to fairness, disclosure, and proper ethical standards, but this has not happened. The Insurance Association of Pakistan has a code of conduct applicable to its members, who cater to both individual and corporate customers. In the microfinance sector, PMN has developed a code of conduct that applies to its members and has recently begun to assess compliance; however, membership in PMN is voluntary, and there is no enforcement mechanism to ensure compliance. PPAF has also imposed the same code on its partner organizations, but again this applies to a restricted universe of microfinance providers. In the securities sector, the Mutual Fund Association of Pakistan (MUFAP) has drafted a code of ethics, but it is still awaiting SECP approval. There is no code of conduct for asset management companies. In Pakistan, the brokers' code of conduct is prescribed as subsidiary legislation, rather than by the stock exchanges, and SECP is currently developing new Broker Rules. None of the existing codes in the securities sector is well known to investors or, in some cases, even to members of the industry associations.

**41. There are comprehensive guidelines and directives on lending practices and debt collection for banks and MFBs (but not for MFIs); but there is no systematic monitoring of these practices from a consumer protection perspective.** There are reports of abusive collection practices involving harassment, particularly, though not exclusively, in the microfinance sector. There are also weaknesses in the assessment of the client's profile and his or her business activity. Both MFIs and MFBs lend to women based on their creditworthiness, but the loan is often used by male family members, despite a provision in the MFB Ordinance that sets penalties for borrowers who use loans for any purpose other than that for which the loan is granted. This practice places women in a vulnerable position.

**42. It is good practice to require financial institutions to provide consumers a reasonable cooling-off period when committing to a long-term financial product or service.** This protects consumers from high-pressure sales practices, and gives them time to consider alternative products or seek independent advice. It is particularly important in a market, such as Pakistan, where the terms of services and products cannot be compared easily. SBP has issued a circular mandating a 14-day cooling-off period for bancassurance products, but this has not been extended to other relevant long-term products including mortgages, or complex or structured products.

**43. Securities and futures brokers who deal with potential and actual customers are not required in the law to be properly trained and certified.** SECP has issued a Circular No. 35 of 2009 requiring brokers to ensure that at least 20 percent of those who deal with clients are certified by examinations administered by the Institute of Capital Markets (ICM). To date, no brokers have complied with even this modest requirement.<sup>10</sup> Sales personnel and traders of stockbroking firms should be formally trained through a certified system and licensed to ensure that only those who possess professional expertise and competence deal with clients to ensure clients are informed in their investment decision. This is particularly important in a demutualized environment where a wider range of products will be distributed to investors. Furthermore, the law does not stipulate fit and proper criteria for the registration of securities and commodity futures brokers that are corporate entities.

**44. Similarly, insurance agents—the first and at times the only point of contact for policyholders—are neither licensed nor certified.** The Insurance Rules prescribe only very basic requirements: a minimum of 10 years of formal education; a foundation course run by Pakistan Insurance Institute for non-life agents; and, for life agents, company training. Insurers are responsible for all materials and information provided to policyholders and potential policyholders by their agents, who are required by law to disclose their status as an agent for an insurer. Individual insurance agents are the primary distribution channel for insurance, and are typically remunerated entirely through commission. In 2010, more than 90 percent of life and non-life insurance was sourced through agents. Although the list of registered insurance brokers and insurance surveyors is available on SECP website, there is no such information available for agents.<sup>11</sup>

**45. There is a long-standing and significant problem with the implementation of compulsory third-party motor liability insurance.** The legislation mandating third-party motor vehicle insurance is separate to the Insurance Ordinance. When a motor vehicle is registered, or when the road tax is collected, a valid third-party motor insurance certificate must be presented. This process is established under the “Saved Chapter” (Chapter VIII) of the otherwise repealed Motor Vehicle Act, 1939. The Saved Chapter, which makes holding third-party motor insurance mandatory for all private vehicles, permits insurers and cooperative societies established under provincial legislation to conduct the business of insurance for the purposes of the Saved Chapter. This is in contravention of the Insurance Ordinance, which specifically requires all insurers to be registered and supervised by SECP. The sale of mandatory policies by unlicensed and unregulated insurers poses a serious risk to consumers that must be addressed.

## *Recommendations*

**46. Principles-based Codes of Conduct should be developed for all segments of the financial sector.** They should be developed with strong participation and buy-in from industry associations, and compliance should be monitored and enforced by regulators or other appropriate self-regulatory bodies that have enforcement powers. The codes should be widely published and disseminated so that consumers are aware of them.

**47. Demutualized exchanges that have front-line supervisory responsibilities need to enhance their market conduct regulations** (as part of their member regulations) to complement SECP’s prescribed Code of Conduct.

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<sup>10</sup> The compliance data is for the circular dated June 30, 2011.

<sup>11</sup> The law does not require agents to be registered with SECP and only insurers are required to maintain a register of their agents but even the insurance companies do not have the information on agents readily available at their respective websites.

**48. For financial products that require a long-term commitment (savings, investment, or credit), a bank should provide the consumer a reasonable cooling-off period (at least three to five days).**

**49. SBP should strengthen its regulation and oversight of MFBS' underwriting, monitoring, and collection procedures.** Examples of prohibited practices should be included in the regulation. PMN and PPAF should adopt similar standards. A study to identify current practices could be undertaken by SBP, PMN, and PPAF to inform regulatory reform and supervisory action. Furthermore, customers need to be made more aware of their rights concerning debt collection practices, foreclosures, and so forth.

**50. There is a particular need to address some widely accepted gender-related practices, such as the passing on of loans by female borrowers and discriminatory loan application criteria.** Gender-specific practices should be reflected in Codes of Conduct of the providers, as well as the code adopted by PPAF and PMN. A working group should be formed to look into specific steps to address this problem, such as greater emphasis on training of loan officers, hiring of more female loan officers, or increased awareness and financial education. In general, for both consumer protection and risk management purposes, MFBS and MFIs should lend strictly to the person who controls the loan. This should be scrutinized as part of supervisory inspections of MFBS, and it appears that SBP has been doing this to some extent.

**51. A standard industry-wide examination for determining the competency of individual salespersons in the brokerage industry should be required.** Nonetheless, in view of brokers' widespread noncompliance by brokers with this requirement, SECP may wish to consider a "tiered" approach toward accreditation, where different levels of certification are required for products of varying degrees of complexity. This should be done in close collaboration with the Institute of Capital Markets as the accreditation body.

**52. The Brokers' and Agent's Rules for both securities and commodities brokers should be amended to incorporate a fit and proper criteria and requirement for high capital standards for brokers.** This should reduce risks to investors of loss caused by brokers' negligent or illegal behavior or brokers' inadequate capital. In addition, it will be critical to introduce an advanced risk-based supervision system for identifying the brokers at highest risk for noncompliance and misconduct.

**53. SECP should also supervise the capabilities and activities of insurance agents more vigorously, either directly or through insurers.** After a suitable transition period, all agents should be required to meet adequate specified SECP requirements, with compliance monitored by SECP through onsite inspections, policyholder surveys of agent activities and behavior, and other things.

**54. The regulation and supervision of the mandated third-party motor vehicle insurance should be brought under the effective ambit of SECP.** The proposal made by SECP and Insurance Association of Pakistan (IAP) in 2007/2008 and agreed to by the federal government to address this should be implemented.

## VI. Dispute Resolution Mechanisms

### *Key Findings*

**55. There are generally sound grievance and redress mechanisms in place for bank customers, though their effectiveness could be further enhanced.** SBP has required all banks to establish clear dispute resolution mechanisms and to maintain proper records of such disputes. Details of these procedures must be posted in all bank branches, and SBP inspects the bank's records and processes for resolving complaints during annual onsite inspections. If a client does not obtain resolution of his grievance from his bank within 45 days, he may refer the matter to the Ombudsman (OBM). Decisions of the OBM may be appealed to the Governor, SBP or ultimately to the courts by consumers, but are binding on banks. Timelines are specified for resolution. Most disputes that go to the Ombudsman are settled through an amicable resolution process, but roughly 20 percent are settled at a hearing held by the OBM. The OBM handled more than 20,000 complaints between its founding in 2005 and 2011; however, the position of the Ombudsman, which is appointed by the President on recommendation of the Governor of SBP, was left vacant for approximately eight months which is created a serious backlog at the OBM, before an appointment was made in March, 2013.

**56. The absence of effective dispute resolution mechanisms is a core weakness in microfinance.** There is no regulatory requirement for either MFIs or MFBs to have an internal customer complaint structure in place. Microfinance clients have fewer channels to resolve grievances than bank clients, and seem to be generally unaware of the few channels that do exist. Although MFBs seem to be required by SBP to have procedures, there are no stipulated standards for handling customer complaints. A few MFIs have also instituted such procedures, but the quality and sophistication vary widely. MFB clients can file complaints with SBP directly, but have no access to the banking ombudsman. MFI clients are left with only the courts to resolve their grievances, which is unacceptable given their lack of resources and unfamiliarity with formal processes. A proposal by the PMN to implement an in-house structure as a pragmatic (even if short-term) solution to the deficient complaint-handling practices has not been agreed to by all stakeholders.

**57. The securities laws and rules and industry codes do not provide for alternative dispute resolution systems for market participants (other than those relating to trades executed on the stock exchanges, which may go to arbitration).** SECP requires all securities intermediaries to have internal complaint-handling procedures for their clients, and its onsite inspection examines their effectiveness. The Karachi Center of Alternative Dispute Resolution has been operational since February 2007 and has recently signed a Memorandum of Understanding (MOU) with SECP, among others, to provide input on developing effective alternative dispute resolution systems in the review of stock exchange regulations. Nonetheless, it would appear that to date, the primary arbitration system for the securities market is part of the stock exchanges' framework in relation to trades on their market. As a result, it does not cover all types of complaints between a customer and an asset management company.

**58. The insurance law and rules do not require insurers to have an internal disputes settlement process,** but most insurers have put in place some form of internal dispute resolution system. The quality of these systems has never been checked, and there is concern that smaller or less reputable insurers may provide limited support for internal dispute resolution. The IAP Code of Conduct makes no reference to dispute resolution processes, internal or external. SECP Circular 18 of 2011 requires all insurers to display on their websites "The information relating to claim/grievance handling mechanism/procedure in detail" no later than January 15, 2012, but internal dispute resolution processes should be made more effective.

**59. The Office of the Insurance Ombudsman was established in May 2006 but is not widely known.** An insurance ombudsman may investigate allegations of misadministration by insurers. Decisions of the insurance ombudsman may be appealed to SECP, and complainants also retain the right to file suit against insurers. The insurance ombudsman may also pass matters on to SECP for further investigation. A relatively small number of complaints have been investigated by the insurance ombudsman. There is also a distinct federal ombudsman, which is referred to by the two state-owned insurers that deal with consumers, the State Life Insurance Corporation and Postal Life Insurance, both of which indicated they were unaware of the insurance ombudsman. The external dispute resolution processes are not well known to the public, and hence their effectiveness is limited.

### *Recommendations*

**60. Consideration should be given to proactively increasing awareness of the OBM, and streamlining procedures to make them more user-friendly.** Roughly two-thirds of those using the service do not comply with the formal procedure, and have to be guided through the process by the OBM. Furthermore, a large number of complaints are directed to the CPD of SBP, which then redirects the complaints to the appropriate financial institution or the OBM for follow-up. This indicates that consumers are not fully aware of the process. SBP, OBM, and/or Pakistan Banks' Association (PBA) should consider conducting a more proactive campaign through the media and other channels to increase awareness. A new ombudsman needs to be appointed as soon as possible. Because rulings can be pronounced only by the ombudsman, the current vacancy is creating a serious backlog. If allowed by law, the authorities should put in place a system to ensure that there will always be an acting ombudsman in the event of a vacancy in the office, either through delegated powers or the automatic appointment of an interim ombudsman.

**61. There is a need to centralize, analyze, and publish data on consumer complaints.** A wealth of data is available on consumer complaints, but the data are dispersed among individual financial institutions, SBP, SECP, the OBM, and provincial councils. For the banking sector, the OBM publishes statistics and analyzes complaints it receives to determine if any issues require policy attention. The CPD also analyzes data on consumer complaints it receives and prepares an annual review. Findings are used for internal analysis, and the CPD has taken several policy initiatives on the basis of conclusions drawn from the findings. This "Annual Review" is not made public, however, and the data analyzed are not comprehensive. A comprehensive and public analysis of all financial consumer complaints would allow regulators and financial institutions to better identify and address recurring problems and areas of weakness in banking practices. This may be an appropriate role for the CPD of SBP.

**62. SBP, PMN, and PPAF should design and enforce an effective mechanism to handle complaints from clients of all microfinance providers, regardless of their regulatory status.** This should be accompanied by increased coordination to exchange, analyze, and disseminate complaints information. The potential to use the PMN as a central redress mechanism should be further explored, as it may be the most practical solution to cover MFIs (even beyond PMN membership). This may require a change in the PMN's statutory mandate and would require a good degree of interagency coordination and a robust governance structure to minimize potential conflicts of interest. Whatever strategy is chosen, increasing awareness of dispute resolution procedures is crucial and will require mass media campaigns and support from SBP. Redress mechanisms must be designed to work for microfinance clients, including those in rural areas with limited access to technologies other than mobile phones. SBP should also set minimum standards for complaint-handling procedures in MFBs, and review their effectiveness. It should use complaints data for regulatory and supervisory purposes, and to design financial literacy and awareness campaigns.

**63. SECP should formalize minimum written requirements for internal dispute resolution processes for all insurers, preferably in collaboration with the industry, and then monitor their effectiveness.** It is also



important to increase awareness of the Office of the Insurance Ombudsman. SECP, with industry involvement, should establish an accessible and effective “one-stop shop” for policyholders and potential policyholders with disputes. It is further recommended that a low-cost ombudsman resolving disputes for smaller retail customers be considered in the securities, futures, and microinsurance markets.

### **FEDERAL OMBUDSMEN INSTITUTIONAL REFORMS ACT, 2013<sup>12</sup>**

The Federal Ombudsmen Institutional Reforms Act, 2013 (the Act) was enacted on February 12, 2013, subsequent to the CPFL Diagnostic Mission. Apart from the Office of Federal Ombudsman (Wafaqi Mohtasib), which was set up in Pakistan in 1983, there are 10 other Ombudsman offices established in the country: four at federal level<sup>13</sup>, five at provincial level<sup>14</sup>, and one in Azad Jammu Kashmir (AJK).

It is not absolutely clear how the Act will be applicable to the Banking Ombudsman Pakistan (BMP) and the insurance ombudsman (IO). However, the consumer protection department of SBP and Insurance Department of SECP have raised concerns that if applicable, certain provisions in the act will have negative implications from a consumer protection perspective, and the CPFL diagnostic team shares this concern, particularly insofar as the BMP appears to be working well. As a sole supervisory authority, SBP is responsible for conduct supervision as well as providing financial consumer protection to the customers of banks and DFIs. Before promulgation of the act, there was a three-tier redressal mechanism for consumers (all banks are required to establish an internal dispute resolution mechanism); any person aggrieved by the resolution provided by the banks has the right to lodge a complaint with the BMP; and finally, SBP is entrusted with the responsibility to act as an appellate body over the BMP. The act states that no court or authority shall have jurisdiction to entertain a matter that falls within the jurisdiction of an ombudsman, nor shall any court or authority assume jurisdiction in respect of any matter pending with or decided by an ombudsman. Thus it is not clear whether SBP will be able to handle consumer/customer complaints or not.

There is also uncertainty regarding the scope of the BMP, because under the Act an ombudsman has jurisdiction over public or autonomous bodies with government shareholding. Does that mean the BMP cannot entertain complaints against private banks? No special provisions have been made regarding banking companies in the new Act.

Similarly, if the new Act applies, the authority for adjudication of appeals against orders from the BMP would be shifted from the SBP governor to the president of Pakistan, but the law is silent on appeals already lodged and adjudicated at SBP. Is the 45-day time frame for disposal of customer complaints applicable to banks? Similarly, in case of complaints against insurance companies, the aggrieved party can file an appeal with the Securities and Exchange Commission of Pakistan, but this may not be the case after the promulgation of the Act.

Further, the BMP is required to send a report to SBP on or before every March 31, reviewing the activities of its office during the preceding year. Now with the promulgation of the Act, there is lack of clarity with regard to knowledge sharing regarding complaints trend analysis.

<sup>12</sup> See annex II.

<sup>13</sup> At federal level there is: Office of Federal Tax Ombudsman, Federal Insurance Ombudsman, Banking Ombudsman, and Federal Ombudsperson for Protection against Harassment of Women at Workplace.

<sup>14</sup> Provincial Ombudsman at Punjab, Sindh, Khyber Pakhtunkhwa, and Baluchistan, respectively, and Provincial Ombudsperson Sindh for Protection against Harassment of Women at Workplace.

## VII. Financial Education

### *Key Findings*

**1. SBP and SECP have recognized the importance of financial education and commenced with structured initiatives to address the existing gaps, though no comprehensive financial education strategy is available yet.** Specifically, as outlined in the Pakistan “10-Year Strategy Paper for the Banking Sector Reforms,”<sup>15</sup> SBP has made financial education one of its strategic priorities. It has committed to sponsoring a long-term campaign to enhance financial literacy in both urban and rural areas, targeting large segments of the population, with the active participation of the banking industry. To this end, SBP, in collaboration with the PPAF and other stakeholders, has already commenced a Nationwide Financial Literacy Program. In addition, SECP has also started to implement a comprehensive Investor Education and Awareness Program primarily focusing on existing and potential investors.<sup>16</sup>

**2. Although the development of the NFLP was not based on a full-fledged financial capability survey, it was informed by the demand- and supply-side financial literacy gap analysis and it used pilot programs prior to full implementation.** The gap analysis included a very limited demand survey of sample target population, as well as a survey of the heads of financial institutions and focus group analysis. Given its importance for development of targeted financial education measures, the suitability of the demand survey instrument is briefly assessed in box 1. The respondents from the financial sector agreed that the NFLP could be beneficial for the general population, which could in turn benefit the financial institutions in terms of increased outreach. Regarding the topics covered, the private sector view was that the financial literacy curriculum should prioritize budgeting and banking products and services.<sup>17</sup> They also recommended considering making the NFLP a continuous effort and implementing school-based financial education.

**3. The NFLP is focused on providing financial education to adult populations between the ages of 18 to 60 in both rural and urban areas, with a specific focus on low-income and marginalized communities, and taking gender equality into consideration.** The first phase of the program included the development of the curriculum and testing of pilot programs that have been delivered to nearly 50,000 people. The next stage includes independent evaluation of the pilot and, following any required changes, scaling up the program to some 500,000 people. The program covered various basic financial topics, such as budgeting, savings, investments, debt management, financial products, and branchless banking. The NFLP is overseen by a committee comprising PMN, PPAF, and PBA, as well as representatives from the education sector, and was managed by Bearing Point Pakistan (now Mazars Pakistan). Further, the program included three components—curriculum development, dissemination, and monitoring and evaluation—and it utilized various delivery channels, including TV, publications, public events, and a website ([www.financialeducation.pk](http://www.financialeducation.pk)). In the future, SBP also plans to expand the NFLP, with programs geared for schoolchildren. Overall, despite the limitation of the initial demand survey, the approach that attempted to assess existing gaps and used a pilot program prior to full implementation was sound, and the initiative is commendable.

<sup>15</sup> <http://www.sbp.org.pk/bsd/10yearstrategyaper.pdf>

<sup>16</sup> For details on issues specific to capital markets and insurance sectors see volume II of this report.

<sup>17</sup> That is, debt management, investment and entrepreneurship, branchless banking, and consumer protection.

### Box 1: Limitations of the Implemented Demand Survey and Future Assessments

**The sampling methodology of the demand survey had significant limitations.** The sample covered only four regions (and seven cities). Further, instead of a probability sampling, some form of quota sampling was used. Finally, the sample size of 336 people was fairly small. As a result, the collected data did not allow making any inferences to the overall population or subpopulation (region or the seven cities,) and was likely biased and not very accurate.<sup>18</sup>

**The questionnaire covered useful topics, but its extent was also limited.** The instrument used has a strong focus on financial inclusion topics, such as access to or experiences with financial products and services. It also gathered valuable information on peoples' attitudes, including their preferences for receiving financial education and reasons for saving, borrowing, and using specific financial products and services. These types of questions were particularly useful to obtain a better understanding of the reasons underlying specific financial decisions. However, the number of questions aimed to measure knowledge, skills, or behaviors that could be associated with financial capability was rather limited.

**Future assessments of financial capability in Pakistan would benefit from questions that cover the following key financial capability areas.** These include (i) basic numeracy skills and understanding of basic financial concepts (e.g., how inflation affects their savings); (ii) day-to-day money management (e.g., planning income against expenditure, prioritizing spending on essentials); (iii) planning for future needs (e.g., making provisions for planned or unexpected expenses, retirement); (iv) ability to choose among financial products (e.g., checking terms and conditions, shopping around, not borrowing more than one can afford); and (v) key motivations (e.g., impulsiveness, achievement and time orientation, risk preferences).

**In this regard, the existing World Bank instrument could be used and tailored to the needs of Pakistan.** The World Bank implemented an extensive qualitative research program, funded by the Russian Trust Fund of Financial Literacy and Education, to identify the key components of financial capability that are specifically relevant in low- and middle-income settings. Based on the results of this empirical research, the World Bank developed a questionnaire that has been extensively tested to ensure that all questions are well understood and meaningful across income and education levels. To date, the instrument was used in fifteen countries (Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Colombia, Lebanon, Mexico, Mongolia, Nigeria, Romania, Russia, Tajikistan, Turkey, Uruguay, and West Bank/Gaza) and is currently applied in four additional countries (Malawi, Mozambique, Morocco, and the Philippines). Because of the extensive development work of the questionnaire, its high relevance for low- and middle-income environments, and the benefit of being able to make cross-country comparisons, it is recommended that this instrument be used for any future assessments of financial capability of Pakistan's population.

**4. The nationwide capital market investor education program launched by SECP seems comprehensive, but it appears that it was primarily based on how SECP and other relevant stakeholders perceived the key issues in investor education.** Although the preferred approach would have been to gauge the issues firsthand by organizing focus groups, an existing investor survey, or some other sort of more structured diagnostic assessment, this was still an excellent initiative. The program was officially launched in July 2012 in

<sup>18</sup> The World Bank team has just recently been informed that a supplemental survey (with a sample size of 670) had been conducted; however, as no substantial information about the survey methodology has been made available to the Bank team, it could not be covered in this report.

collaboration with the three Stock Exchanges, the Mercantile Exchange, Central Depository Company, National Clearing Company, and the MUFAP, and will be implemented under the Institute of Capital Markets. The key objectives of the program are to empower the investors with knowledge to make better decisions, understand and manage risks, promote investing, expand outreach, and so forth. The delivery mechanisms include an investor education website, seminars, educational materials, and the media campaign.

**5. The target groups primarily include university students, general investors (both existing and potential), and gray investors (close to retirement age).** In addition, in early 2013, SECP also plans to include lower-income individuals (with monthly income under Rs. 30,000) as a separate target group, with the goal of increasing their financial literacy and financial access. The first three target groups include existing and potential investors, and therefore represent a natural target market for SECP; however, lower-income individuals are unlikely to become capital markets investors, and moreover they may already be covered under the NFLP. In this regard, it may be prudent if SECP maintained a focus on its natural target market, while the lower-income individuals could be covered under the NFLP. This would exclude any potential overlaps and result in more efficient use of limited resources.

**6. There are also limited private sector initiatives focusing on financial education, primarily developed and run by financial institutions and focused on their customers.** For example, First Microfinance Bank used to promote two learning modules focused on budgeting and cash flow management linked to savings programs; interestingly, the recipients were willing to pay to attend the courses, thus indicating perceived value. In addition, Kashf Foundation launched a Financial Education Program in 2010, comprising basic financial literacy and systemized financial education, and has reported training of more than 300,000 clients. In addition to this, the results from the Banking Heads Survey Analysis, implemented under the NFLP, indicated that although no institution was catering specifically to the national financial literacy needs, isolated cases of semiformal financial literacy initiatives did exist. Overall, such private sector initiatives are encouraging and should be used for delivery of financial education initiatives.

### *Key Recommendations*

**7. A full-fledged Financial Capability Survey should be considered.** The existing programs are encouraging and should continue until improved alternatives are available; however, it would be beneficial to conduct a nationally representative financial capability survey. This is important to more thoroughly assess existing gaps, ensure that the proposed programs properly respond to the needs of future beneficiaries, and to identify key priorities that need to be addressed. Such a survey would also be useful for identifying how financial inclusion and financial sector policies could be made more effective. For example, it could provide insights on trust and confidence in financial institutions/regulators and awareness of particular financial services or initiatives. In this regard, as elaborated in box 1, it is suggested that the authorities consider using the survey questionnaire developed by the World Bank, which has already been tested and which could benchmark Pakistan against other countries. Further, a follow-up survey in three to five years should be carried out to measure impact of the implementation of financial education measures, and programs should be adjusted as necessary. As an alternative, the planned FinScope update could be expanded to include financial capability questions for this purpose, but this this would limit the scope for questions and therefore also the value of the questions for SBP and SECP.

**An integrated Financial Education Strategy is recommended.** The proposed strategy should be based on the financial capability survey, also considering evaluation and lessons learned from existing public and private programs, and should include a set of key priorities to be addressed in the implementation stage. Its delivery

mechanisms should also use existing successful programs as much as possible. The World Bank's recent brief<sup>19</sup> on financial education programs and strategies which discusses approaches and available resources in this area may be useful source of information in this regard. While the proposed strategy should include all programs under one roof, the implementation of different activities can be delegated to different authorities in line with their mandates and expertise (SBP, SECP, etc.). This approach would ensure better coordination and outreach as it would minimize fragmentation. Overall, given its experience with the NFLP and dominant role in financial sector regulation, it is suggested that SBP takes the lead in coordinating this process, in close consultation with SECP and in coordination with other relevant stakeholders, and ensuring high-level government support.

**8. Planned school-based financial education initiatives should also be based on tailored diagnostic work.** This may include focus groups and surveys, in order to properly gauge the baseline capability of schoolchildren. Another option would be to consider adding a booster sample to the financial capability survey (which otherwise would not provide specific insights to this segment of population) focusing on school-aged children. The diagnostic work in this area should be conducted in consultation with the Ministry of Education.

**9. The design of new financial education programs should be informed by the impact assessments of already implemented initiatives, whereas their implementation should rely on pilots before full-scale rollout, and should include impact evaluation mechanisms from the outset.** The World Bank has already completed a number of evaluation studies<sup>20</sup> of financial capability programs which could be a good source of information on lessons learned. Further, as a matter of good practice, it is very important to require implementation of all activities on a small scale first, and only after evaluation of such programs (via surveys, pilot tests, randomized control trials, etc.) should they be subject to full-scale implementation. This approach would enhance effectiveness and safeguard resources. The World Bank has also developed an operational toolkit<sup>21</sup> on methods for evaluating financial capability programs) that could be used to support evaluation of existing initiatives. Finally, in terms of institutional roles, there could be a role for other stakeholders in addition to SBP and SECP. For example, the Ministry of Education could be involved regarding the development of curriculum and piloting of school-based programs, and financial services sector (e.g., professional associations, banks, microfinance institutions) could contribute to the development and delivery of specific financial education programs.

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<sup>19</sup> <http://responsiblefinance.worldbank.org/~media/GIAWB/FL/Documents/Publications/Financial-Education-Programs-and-Strategies.pdf>

<sup>20</sup> <http://responsiblefinance.worldbank.org/~media/GIAWB/FL/Documents/Publications/evaluation-studies-of-programs-to-enhance-financial-capability-in-low-and-middle-income-countries-summary.pdf>

<sup>21</sup> <http://www.finlitedu.org/evaluation/wb/>

## Annex I

List of Key Recommendations<sup>22</sup>

Recommendations	Responsible Organization	Term <sup>23</sup>	Priority
<b><i>Institutional Arrangements</i></b>			
Establish an effective coordination mechanism for financial consumer protection among regulators and relevant key stakeholders, to form a strategic perspective on this matter in capital markets, insurance, microfinance, and banking. Define joint priorities; clarify roles and responsibilities of each stakeholder. Under this mechanism, working groups for each sector could be created.	<b>SBP, SECP, CCP, PMN, PBA, PPAF,</b> and other key stakeholders	ST	High
Conduct an assessment of and implement the most suitable and pragmatic institutional setup to address existing institutional gaps in nonbank microfinance consumer protection, and extend basic minimum standards to MFIs. This should include encouraging MFIs to register under Section 42 of the Companies Ordinance, and creating a central registry of all microfinance providers, which should be available to the wider public.	PMN, PPAF, <b>SBP, SECP</b>	S/MT	High
Strengthen risk-based supervision by demutualized exchanges in regard to their front-line responsibilities and establish oversight framework for SECP	<b>SECP, KSE, ISE, LSE</b>	LT	Medium
Clarify the role of the Ministry of Commerce vis-à-vis SECP in insurance. All government-owned insurers should be brought under SECP.	GOP, SECP	MT	Medium
Strengthen SECP's risk-based supervisory and enforcement capacity to deal with noncompliance and malpractices in the insurance and securities sectors. Consider bringing under SECP's direct regulatory and supervisory ambit insurance agents and other intermediaries, and the mandated third-party motor vehicle insurance.	<b>SECP, GOP</b>	LT	High
<b><i>Legal and Regulatory Framework</i></b>			
Affirm SBP's mandate for consumer protection in banking and microfinance when amending or replacing the BCO and the MFB Ordinance.	SBP, GOP	MT	Medium
Design and implement a pragmatic solution to address the fragmentation of the legal framework for nonbank microfinance, recognizing and expanding the role of the PMN and PPAF in implementing standards with strong support from SBP and SECP.	PMN, PPAF, <b>SBP, SECP</b>	ST	High

<sup>22</sup> In bold, suggested institution(s) to assume a lead role.

<sup>23</sup> ST, short term, indicates action can be undertaken in zero to six months. MT, medium term, indicates six months to one year. LT, long term, indicates more than one year.



<b>Recommendations</b>	<b>Responsible Organization</b>	<b>Term</b> <small>23</small>	<b>Priority</b>
Improve the regulatory framework for MFBs with regard to consumer risks and adapt the supervisory review. Enhance inter-departmental coordination to improve data collection and assessment of consumer risks in MFBs.	SBP	ST	High
Enhance the market conduct regulations of demutualized exchanges that have front-line supervisory responsibilities (as part of their member regulations) to complement SECP's prescribed code of conduct.	KSE, ISE, LSE, SECP	MT	Medium
Amend SECP Act to vest in SECP a wider range of enforcement tools, and introduce a civil liability on securities intermediaries who fail to implement effective KYC procedures.	SECP, GOP, ICM	MT	Medium
Review and amend the insurance regulatory framework, to update it with present practice and remove anomalies. Introduce consumer protection provisions, including for microinsurance.	SECP, GOP	ST	Medium
Clarify the position on depositor protection through appropriate legislation to introduce deposit insurance for small depositors.	GOP, SBP	MT	Medium
<b><i>Disclosure and Business Practices</i></b>			
If not yet available, financial institutions and industry bodies should design, implement, and widely disseminate (with support from regulatory bodies) principles-based codes of conduct. Industry bodies in microfinance, banking, insurance, and securities should devise alternatives to monitor implementation and, to the extent allowed by their legal mandates, regulators should monitor adherence to the codes.	SBP, SECP, PBA, MUFAP, KSE, ISE, LSE, PMN, PPAF, IAP	ST	High
Develop and require the application by all financial institutions, including microfinance banks, of standard methodologies to disclose total price or cost of consumer financial products. Introduce similar standards for MFIs.	SBP, SECP, PMN, PPAF	MT	High
Require retail consumer contracts to follow standards such as minimum content of terms and conditions, and require financial institutions to provide them in plain language, in Urdu and in English (and other local languages when needed). For illiterate clients, require that terms and conditions be read aloud.	<b>SBP, SECP</b> , PBA, MUFAP, KSE, ISE, LSE, PMN, PPAF, IAP	ST	High
Require Key Facts Statements (KFSs) for all basic consumer finance products, including banking, microfinance, insurance, and securities. The KFS needs to be adapted to the specific needs of each sector.	<b>SBP, SECP</b> , PMN, PPAF, KSE, ISE, LSE, MUFAP, IAP	ST	High
Require, for all consumer products representing long-term commitments or which may be subject to high-pressure sales contracts, as well as microfinance loans, a reasonable cooling-off period (three to five days minimum), which may need to be longer for microfinance.	<b>SBP, SECP</b> , PMN, PPAF, MUFAP, IAP	ST	Medium
Ensure that useful comparative standardized price and cost	<b>SBP, SECP</b> ,	MT	Medium

<b>Recommendations</b>	<b>Responsible Organization</b>	<b>Term</b> 23	<b>Priority</b>
information is made available to the general public for basic consumer financial products in the banking, microfinance, securities, and insurance sectors.	KSE, ISE, LSE, MUFAP, PMN, PPAF, IAP		
Introduce regulatory definitions of prohibited loan underwriting and collection practices in microfinance and strengthen assessment of adherence to the standards.	SBP, PPAF, PMN	ST	Medium
Implement strong sanctions for unauthorized trading and misrepresentations by brokers of their status and the suitability of investments.	SECP, KSE, ISE, LSE, MUFAP	MT	High
<b><i>Dispute Resolution Mechanisms</i></b>			
Ensure that there are no gaps in appointments of the banking ombudsman so that there is no institutional vacuum in future. Consider expanding statutory mandate to MFBs. <sup>24</sup>	SBP, GOP	S/MT	High
Develop alternative dispute resolution mechanisms with speedy low-cost procedures for securities, insurance, and MFIs. One alternative could be a single financial ombudsman covering all sectors.	SECP, KSE, ISE, LSE, MUFAP, PBA, PMN, PPAF, consumer courts	MT	High
Strengthen SECP's complaint-handling process, appointing a central point of contact for investors. Develop a client charter and processes to ensure prompt complaint resolution. Move toward an accessible and effective "one-stop shop" for complainants.	SECP	ST	High
Set minimum standards for internal complaints handling mechanisms, standardized terminology and data collection on complaints handled by banks, microfinance providers (MFBs and MFIs), SBP, PPAF, SECP, and respective ombudsman. A relevant authority or industry body should analyze data and publish compiled statistics and findings regularly and use findings to formulate appropriate policies in CPFL.	SBP, SECP, BMP, PBA, PMN, PPAF.	MT	High
<b><i>Financial Education</i></b>			
Implementation of financial education initiatives should include a phased approach, rely on pilots prior to full-scale rollout, and incorporate impact evaluation mechanisms from the outset.	SBP, SECP, CCP, GOP, and all relevant stakeholders in each sector.	MT	High
Consider a full-fledged nationally representative Financial Capability Survey.	SBP, SECP	MT	High
Develop an integrated Financial Education Strategy, based on the implemented Financial Capability Survey.	SBP, SECP, Industry	MT	High

<sup>24</sup> Depending on applicability of Federal Ombudsmen Institutional Reform Act, 2013.

<b>Recommendations</b>	<b>Responsible Organization</b>	<b>Term</b> <small>23</small>	<b>Priority</b>
	Associations		
School-based financial education programs should also be based on tailored diagnostic work, such as focus groups or surveys; consideration may be given to adding a booster sample to the proposed financial capability survey.	SBP, SECP, MoF	MT	Medium
Make effective efforts to increase awareness by retail clients of all financial sectors, including microfinance, of redress mechanisms and how to use them to solve problems with service providers.	PPAF, PMN, SBP, SECP, GOP	ST	High

## Annex II

### The Federal Ombudsmen Institutional Reforms Act, 2013

The following are salient features of the Act, some of which may have significant implications on the scope and powers of the Banking Ombudsman Pakistan (BMP) and Insurance Ombudsman (IO):

1. *Oath before the President:* The Act mandates that the BMP and IO take an oath before the President of Pakistan, whereas there was no such requirement under the Banking Companies Ordinance (BCO) or the Insurance Ordinance.
2. *Tenure:* The tenure of the Ombudsman under the Act is four years, and the ombudsman will continue to hold office until replaced. The tenure of the BMP, under the Banking Companies Ordinance (BCO) is three years and under the Insurance Ordinance 2000, the IO is appointed for four years. There is no provision for continuity if the no successor is appointed.
3. *Acting Ombudsman:* The Act provides for appointment of an Acting Ombudsman in a situation where the office of Ombudsman is vacant or is unable to perform his functions. There is no such provision in the BCO or Insurance Ordinance.
4. *Grievance Commissioner:* The Act empowers the ombudsmen to appoint a grievance commissioner in an agency (owned or controlled by the government) if there are a large number of complaints consistently received against that agency.
5. *Enhanced Powers of Ombudsmen:* Apart from the powers presently exercised, the Act allows ombudsmen the power of civil court for grant of temporary injunctions (stay orders) and implementation of recommendations, orders, or decisions. Under the BCO, the BMP was dependent on the State Bank of Pakistan for ensuring compliance with its orders. The Act also empowers the ombudsman to review its own decision, an option that was not available to the BMP and IO. The review of findings, recommendations, orders, or decisions, pursuant to a review petition, has to be decided within 45 days.
6. *Appellate Power:* The Act allows appeal against the order of ombudsmen only before the President of Pakistan. The BCO allows appellate power to the Governor of SBP and in the case of insurance, the aggrieved party can file an appeal with the commission at SECP.
7. *Administrative and Financial Arrangements:* The Act allows the remuneration payable to the ombudsman and the administrative expenses of the office to be charged to the Federal Consolidated Fund. Whereas under the BCO, the OBM secretariat's cost has to be shared by the scheduled banks proportionately, as determined by the State Bank of Pakistan.
8. *Bar of Jurisdiction:* The Act states that no court or authority shall have jurisdiction to entertain a matter that falls within the jurisdiction of an ombudsman nor will any court or authority assume jurisdiction in respect to any matter pending with or decided by an Ombudsman. If applicable, this will be contrary to what is envisaged under the BCO; under that, the BMP was barred from entertaining any complaint or application that had already been disposed of by SBP or any court in Pakistan.