GENERAL

DEFINITIONS

1. **Bank** means a banking company as defined in the Banking Companies Ordinance, 1962.
2. **Borrower** means an individual to whom a bank / DFI has allowed any consumer financing during the course of business.
3. **Consumer Financing** means any financing allowed to individuals for meeting their personal, family or household needs. The facilities categorized as Consumer Financing are given as under:

(i) **Credit Cards** mean cards which allow a customer to make payments on credit. Supplementary credit cards shall be considered part of the principal borrower for the purposes of these regulations. Corporate Cards will not fall under this category and shall be regulated by Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SMEs Financing as the case may be. The regulations for credit cards shall also be applicable on charge cards, debit cards, stored value cards and BTF (Balance Transfer Facility).

(ii) **Auto Loans** mean the loans to purchase the vehicle for personal use.

(iii) **Housing Finance** means loan provided to individuals for the purchase of residential house / apartment / land. The loans availed for the purpose of making improvements in house / apartment / land shall also fall under this category.

(iv) **Personal Loans** mean the loans to individuals for the payment of goods, services and expenses and include Running Finance / Revolving Credit to individuals.

4. **DFI** means Development Financial Institution and includes the Pakistan Industrial Credit and Investment Corporation (PICIC), the Saudi Pak Industrial and Agricultural Investment Company Limited, the Pak Kuwait Investment Company Limited, the Pak Libya Holding Company Limited, the Pak Oman Investment Company (Pvt.) Limited, Investment Corporation of Pakistan, House Building Finance Corporation and any other financial institution notified under Section 3-A of the Banking Companies Ordinance, 1962.
5. **Documents** include vouchers, cheques, bills, pay-orders, promissory notes, securities for leases / advances and claims by or against the bank / DFI or other papers supporting entries in the books of a bank / DFI.
6. **Equity** of the Bank / DFI means Tier-I Capital or Core Capital and includes paid-up capital, general reserves, balance in share premium account, reserve for issue of bonus shares and retained earnings / accumulated losses as disclosed in latest annual audited financial statements. In case of branches of foreign banks operating in Pakistan, equity will mean capital maintained, free of losses and provisions, under Section 13 of the Banking Companies Ordinance, 1962.
7. **Financial Institutions** mean banks, Development Financial Institutions (DFIs) and Non-Banking Finance Companies (NBFCs).
8. Government Securities shall include such types of Pak. Rupee obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government as the Federal Government may, by notification in the Official Gazette, declare, to the extent determined from time to time, to be Government Securities.
9. **Liquid Assets** are the assets which are readily convertible into cash without recourse to a court of law and mean encashment / realizable value of government securities, bank deposits, certificates of deposit, shares of listed companies which are actively traded on the stock exchange, NIT Units, certificates of mutual funds, Certificates of Investment (COIs) issued by DFIs / NBFCs rated at least ‘A’ by a credit rating agency on the approved panel of State Bank of Pakistan, listed TFCs rated at least ‘A’ by a credit rating agency on the approved panel of State Bank of Pakistan and certificates of asset management companies for which there is a book maker quoting daily offer and bid rates and there is active secondary market trading. These assets with appropriate margins should be in possession of the banks / DFIs with perfected lien.

Guarantees issued by domestic banks / DFIs when received as collateral by banks / DFIs will be treated at par with liquid assets whereas, for guarantees issued by foreign banks, the issuing banks’ rating, assigned either by Standard & Poors, Moody’s or Fitch-Ibca, should be ‘A’ and above or equivalent.

The inter-branch indemnity / guarantee issued by the bank's overseas branch in favor of its sister branch in Pakistan, would also be treated at par with liquid assets, provided the bank is rated 'A' and above or equivalent either by Standard & Poors, Moody's or Fitch-Ibca.

The indemnity for this purpose should be similar to a guarantee i.e. unconditional and demand in nature.

10. **NBFC** means Non-Banking Finance Company and includes a Modaraba, Leasing Company, Housing Finance Company, Investment Bank, Discount House, Asset Management Company and a Venture Capital Company.

11. **Secured** means exposure backed by tangible security with appropriate margins (in cases where margin has been prescribed by State Bank of Pakistan, appropriate margin shall at least be equal to the prescribed margin). Exposure without any tangible security is defined as clean.

12. **Tangible Security** means liquid assets (as defined in these Prudential Regulations), mortgage of land and building, hypothecation or charge on vehicle, but does not include hypothecation of household goods, etc.

MINIMUM REQUIREMENTS FOR CONSUMER FINANCING

Apart from the specific regulations given under each mode of financing separately, general requirements laid down here should also be followed by the banks / DFIs while undertaking consumer financing. It may be noted that these are the minimum requirements and should not in any way be construed to restrict the role of the management of the banks / DFIs to further strengthen the risk management processes through establishing comprehensive credit risk management systems appropriate to their type, scope, sophistication and scale of operations.

The Board of Directors of the banks / DFIs are required to establish policies, procedures and practices to define risks, stipulate responsibilities, specify security requirements, design internal controls and then ensure strict compliance with them.

PRE-OPERATIONS:

Before embarking upon or undertaking consumer financing, the banks / DFIs shall implement / follow the guidelines given below. The banks / DFIs already involved in the consumer financing will ensure compliance with these guidelines within six months of the date of issuance of Prudential Regulations for Consumer Financing.

1. Banks / DFIs shall establish separate Risk Management capacity for the purpose of consumer financing, which will be suitably staffed by personnel having sufficient expertise and experience in the field of consumer finance / business.

2. The banks / DFIs shall prepare comprehensive consumer credit policy duly approved by their Board of Directors (in case of foreign banks, by Country Head and Executive / Management Committee), which shall interalia cover loan administration, including documentation, disbursement and appropriate monitoring mechanism. The policy shall explicitly specify the functions, responsibilities and various staff positions' powers/ authority relating to approval / sanction of consumer financing facility.

3. For every type of consumer finance activity, the bank / DFI shall develop a specific program. The program shall include the objective / quantitative parameters for the eligibility of the borrower and determining the maximum permissible limit per borrower.

4. Banks / DFIs shall put in place an efficient computer based MIS for the purpose of consumer finance, which should be able to effectively cater to the needs of consumer financing portfolio and should be flexible enough to generate necessary information reports used by the management for effective monitoring of the bank's / DFI's exposure in the area. The MIS is expected to generate the following periodical reports:

- Delinquency reports (for 30, 60, 90, 180 & 360 days and above) on monthly basis.
- Reports interrelating delinquencies with various types of customers or various attributes of the customers to enable the management to take important policy decisions and make appropriate modifications in the lending program.
- Quarterly product wise profit and loss account duly adjusted with the provisions on account of classified accounts. These profit and loss statements should be placed before the Board of Directors in

the immediate next Board Meeting. The branches of foreign banks in order to comply with this condition shall place the reports before a committee comprising of CEO / Country Manager, CFO and Head of Consumer Business.

5. The banks / DFIs shall develop comprehensive recovery procedures for the delinquent consumer loans. The recovery procedures may vary from product to product. However, distinct and objective triggers should be prescribed for taking pre-planned enforcement / recovery measures.

6. The banks / DFIs desirous of undertaking consumer finance will become a member of at least one Consumer Credit Information Bureau. Moreover, the banks / DFIs may share information / data among themselves or subscribe to other databases as they deem fit and appropriate.

7. The financial institutions starting consumer financing are encouraged to impart sufficient training on an ongoing basis to their staff to raise their capability regarding various aspects of consumer finance.

8. The banks / DFIs shall prepare standardized set of borrowing and recourse documents (duly cleared by their legal counsels) for each type of consumer financing.

OPERATIONS:

1. Consumer financing, like other credit facilities, must be subject to the bank's / DFI's risk management process setup for this particular business. The process may include, identifying source of repayment and assessing customers' ability to repay, his / her past dealings with the bank / DFI, the net worth and information obtained from a Consumer Credit Information Bureau.

2. At the time of granting facility under various modes of consumer financing, banks / DFIs shall obtain a written declaration from the borrower divulging details of various facilities already obtained from other financial institutions. The banks / DFIs should carefully study the details given in the statement and allow fresh finance / limit only after ensuring that the total exposure in relation to the repayment capacity of the customer does not exceed the reasonable limits as laid down in the approved policies of the banks / DFIs. The declaration will also help banks / DFIs to avoid exposure against a person having multiple facilities from different financial institutions on the strength of an individual source of repayment.

3. Before allowing any facility, the banks / DFIs shall preferably obtain credit report from the Consumer Credit Information Bureau of which they are a member. The report will be given due weightage while making credit decision.

4. Internal audit and control function of the bank / DFI, apart from other things, should be designed and strengthened so that it can efficiently undertake an objective review of the consumer finance portfolio from time to time to assess various risks and possible weaknesses. The internal audit should also assess the adequacy of the internal controls and ensure that the required policies and standards are developed and practiced. Internal audit should also comment on the steps taken by the management to rectify the weaknesses pointed out by them in their previous reports for reducing the level of risk.

5. The banks / DFIs shall ensure that their accounting and computer systems are well-equipped to avoid charging of mark-up on mark-up. For this purpose, it should be ensured that the mark-up charged on the outstanding amount is kept separate from the principal.

6. The banks / DFIs shall ensure that any repayment made by the borrower is accounted for before applying mark-up on the outstanding amount.

DISCLOSURE / ETHICS:

The banks / DFIs must clearly disclose, all the important terms, conditions, fees, charges and penalties, which interalia include Annualized Percentage Rate, pre-payment penalties and the conditions under which they apply. For ease of reference and guidance of their customers, banks / DFIs are encouraged to publish brochures regarding frequently asked questions.

For the purposes of this regulation, Annualized Percentage Rate means as follows:

$$\frac{\text{Mark-up paid for the period}}{\text{Outstanding Principal Amount}} \times \frac{360}{\text{No. of Days}} \times 100$$

REGULATIONS FOR HOUSING FINANCE

REGULATION R-15

Banks / DFIs shall determine the housing finance limit, both in urban and rural areas, in accordance with their internal credit policy, credit worthiness and loan repayment capacity of the borrowers. At the same time, while determining the credit worthiness and repayment capacity of the prospective borrower, banks / DFIs shall ensure that the total monthly amortization payments of consumer loans, inclusive of housing loan, should not exceed 50% of the net disposable income of the prospective borrower.

Banks / DFIs will not allow housing finance purely for the purchase of land / plots; rather, such financing would be extended for the purchase of land / plot and construction on it. Accordingly, the sanctioned loan limit, assessed on the basis of repayment capacity of the borrower, value of land / plot and cost of construction on it etc., should be disbursed in tranches, i.e. up to a maximum of 50% of the loan limit can be disbursed for the purchase of land/ plot, and the remaining amount be disbursed for construction there-upon. Further, the lending bank / DFI will take a realistic construction schedule from the borrower before allowing disbursement of the initial loan limit for the purchase of land / plot.

Banks / DFIs may allow housing finance facility for construction of houses against the security of land / plot already owned by their customers. However, the lending bank / DFI will ensure that the loan amount is utilized strictly for the construction purpose and loan is disbursed in tranches as per construction schedule.

Loans against the security of existing land / plot, or for the purchase of new piece of land / plot, for commercial and industrial purposes may be allowed. But such loans will be treated as Commercial Loans, which will be covered either under Prudential Regulations for Corporate / Commercial Banking or Prudential Regulations for SMEs Financing.

Banks / DFIs may allow Housing Loans in the rural areas provided all relevant guidelines/regulations on the subject are complied with by them.

REGULATION R-16

The housing finance facility shall be provided at a maximum debt-equity ratio of 85:15.

REGULATION R-17

Banks / DFIs may extend mortgage loans for housing upto any tenure defined in bank's/DFI's policy duly approved credit policy and keeping in view the maturities profile of their assets and liabilities.

REGULATION R-18

The house financed by the bank / DFI shall be mortgaged in bank's / DFI's favour by way of equitable or registered mortgage.

REGULATION R-19

Banks / DFIs shall either engage professional expertise or arrange sufficient training for their concerned officials to evaluate the property, assess the genuineness and integrity of the title documents, etc.

It may, however, be noted that the requirement of full-scope and desk-top evaluation, as required under R-8 and R-11 of Prudential Regulations for Corporate / Commercial Banking and SMEs Financing respectively, will not be applicable on housing finance.

REGULATION R-20

The bank's / DFI's management should put in place a mechanism to monitor conditions in the real estate market (or other product market) at least on quarterly basis to ensure that its policies are aligned to current market conditions.

REGULATION R-21

Banks / DFIs are encouraged to develop floating rate products for extending housing finance, thereby managing interest rate risk to avoid its adverse effects. Banks / DFIs are also encouraged to develop in-house system to stress test their housing portfolio against adverse movements in interest rates as also maturity mismatches.

REGULATION R-22

The mortgage loans shall be classified and provided for in the following manner:

Classification	Determinant	Treatment of Income	Provisions to be made*
(1)	(2)	(3)	(4)
1. Substandard	Where markup/ interest or principal is overdue by 90 days or more from the due date.	Unrealized markup/ interest to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized mark up/ interest already taken to income account to be reversed and kept in Memorandum Account.	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of mortgaged properties to the extent of 50% of such FSV.
Doubtful	Where markup/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of mortgaged properties to the extent of 50% of such FSV.
Loss	Where markup/ interest or principal is overdue by one year or more from the due date.	As above.	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of mortgaged properties to the extent of 50% of such FSV for first and second year and 30% of FSV for third year from the date of classification. Benefit of FSV against NPLs shall not be available after 3 years from the date of classification of loan.

** These specific provisions will be in addition to general reserve maintained under Regulation R-4*

This document is part of 'Prudential Regulations for Consumer Finance' which can be accessed at http://www.sbp.org.pk/publications/prudential/PRs-Consumer.pdf