PRUDENTIAL REGULATIONS FOR SMALL AND MEDIUM ENTERPRISES FINANCING

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BANKING POLICY DEPARTMENT

STATE BANK OF PAKISTAN

PRUDENTIAL REGULATIONS TEAM

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C O N T E N T S

P R E F A C E

Keeping in view the important role of Small and Medium Enterprises (SMEs) in the economic development of Pakistan and to facilitate and encourage the flow of bank credit to this sector, a separate set of Prudential Regulations specifically for SME-sector is being issued by State Bank of Pakistan. It is expected that this separate set of regulations, specifically tailored for SMEs, shall encourage banks / DFIs to develop new financing techniques and innovative products which can meet the financial requirements of SMEs and provide a viable and growing lending outlet for banks / DFIs.

Banks / DFIs should recognize that success in SME lending requires much more extensive involvement with the SMEs than the traditional lender-borrower relationship envisages. The banks / DFIs are, thus, encouraged to work in close association with SMEs. The banks / DFIs should assist and guide the SMEs to develop appropriate systems and effectively manage their resources and risks.

The banks / DFIs are encouraged to prepare a lending program (including detailed eligibility criteria) for each specific sub-sector of SME in which they want to take exposure in a significant manner. For this purpose, the banks / DFIs may conduct / arrange surveys and research to determine the status and potential of specific SME sub-sectors. It is expected that banks / DFIs would prepare comprehensive guidelines / manuals and put in place suitable mechanism / structure, aided by proper MIS, to carry out the activities related to SME financing in an effective way. This should, however, not stop banks / DFIs from lending to SMEs before undertaking the steps mentioned above as the banks / DFIs may start soft lending operations or test marketing campaigns, as they feel appropriate, to gain experience and necessary know how. The factors mentioned above gain more importance and become critical for the success of a bank / DFI in SME lending, as the exposure of the bank / DFI on SMEs becomes a significant portion of its loan portfolio.

State Bank of Pakistan encourages banks / DFIs to lend to SMEs on the basis of assets conversion cycle and future cash flows. A problem, which the banks / DFIs may encounter in this respect, is the lack of adequate information. In order to overcome this problem, banks / DFIs may also like to prepare general industry cash flows and then adjust those cash flows for the specific borrowers keeping in view their conditions and other factors involved.

As mentioned above, presently most of the SMEs in Pakistan lack sophistication to have reliable and sufficient data and financial information. In order to capture this data and information, banks / DFIs will need to assist and guide their SME customers. The banks / DFIs may come up with the minimum information requirements and standardized formats for this purpose as per their own discretion. For better understanding and to facilitate their SME customers, banks / DFIs are encouraged to translate their loan application formats and brochures in Urdu and other regional languages.

Banks should realize that delay in processing the cases might frustrate the SMEs. Banks are therefore encouraged to process the loan cases expeditiously and convey the decision to the SME borrowers as early as possible

In order to encourage close coordination of the officials of the banks / DFIs and SMEs, the banks / DFIs may require the concerned dealing officer to regularly visit the borrower. For this purpose, at a minimum, the dealing officer may be required to pay at least one quarterly visit and document the state of affairs of the SME. In addition, an officer senior to the one conducting these regular visits, may also visit the SME at least once in a year. The banks may, at their own discretion, correlate the frequency of visits with their total exposure to the SME borrower.

State Bank of Pakistan will closely monitor the situation on an ongoing basis and work proactively with banks / DFIs to make SME financing a success. During this process, we will keep on reviewing regulatory framework to ensure that any impediment is immediately removed while ensuring that banks / DFIs observe due prudence and necessary oversight.

MUHAMMAD KAMRAN SHEHZAD
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PART – A
DEFINITIONS

For the purpose of these regulations:

1. **Bank** means a banking company as defined in Banking Companies Ordinance, 1962.

2. **Borrower** means a SME on which a bank / DFI has taken any exposure during the course of business.

3. **Corporate Card** means credit card issued to the employees of a SME where the repayment is to be made by the said SME.

4. **Contingent liability** means:
   (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or
   (b) a present obligation that arises from past events but is not recognized because:
      (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
      (ii) the amount of the obligation cannot be measured with sufficient reliability;

   and includes letters of credit, letters of guarantee, bid bonds / performance bonds, advance payment guarantees and underwriting commitments.

5. **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 and any other financial institution notified under Section 3A of the Banking Companies Ordinance, 1962.

6. **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.

7. **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.

8. **Equity of the Borrower** includes paid-up capital, general reserves, balance in share premium account, reserve for issue of bonus shares and retained earnings / accumulated losses, revaluation reserves on account of fixed assets and subordinated loans.

   Revaluation reserves will remain part of the equity for first three years only, from the date of asset revaluation, during which time the borrower will strengthen its equity base to enable it to avail facilities without the benefit of revaluation reserves.

9. **Exposure** means financing facilities whether fund based and / or non-fund based and include:

   (i) Any form of financing facility extended or bills purchased/ discounted except ones drawn against the L/Cs of banks / DFIs rated at least 'A' by Standard & Poor, Moody's, and Fitch-Ibca or credit rating agency on the approved panel of State Bank of Pakistan and duly accepted by such L/C issuing banks / DFIs
   (ii) Any financing facility extended or bills purchased/discounted on the guarantee of the person.
   (iii) Subscription to or investment in shares, Participation Term Certificates, Term Finance Certificates or any other Commercial Paper by whatever name called (at book value) issued or guaranteed by the persons.
   (iv) Credit facilities extended through corporate cards.
   (v) Any financing obligation undertaken on behalf of the person under a letter of credit including a stand-by letter of credit, or similar instrument.
   (vi) Loan repayment financial guarantees issued on behalf of the person.
   (vii) Any obligations undertaken on behalf of the person under any other guarantees including underwriting commitments.
   (viii) Acceptance / endorsements made on account.
   (ix) Any other liability assumed on behalf of the client to advance funds pursuant to a contractual commitment.

10. **Forced Sale Value (FSV)** means the value which fully reflects the possibility of price fluctuations and can currently be obtained by selling the mortgaged / pledged assets in a forced / distressed sale conditions.

11. **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.

12. **Group** mean persons, whether natural or juridical, if one of them or his dependent family members or its subsidiary, have control or hold

substantial ownership interest or have power to exercise significant influence over the other or are financially interdependent on each other. For the purpose of this:

(a) **Subsidiary** will have the same meaning as defined in sub-section 3(2) of the Companies Ordinance, 1984 i.e. a company or a body corporate shall deemed to be a subsidiary of another company if that other company or body corporate directly or indirectly controls, beneficially owns or holds more than 50% of its voting securities or otherwise has power to elect and appoint more than 50% of its directors.

(b) **Control** refers to an ownership directly or indirectly through subsidiaries, of more than one half of voting power of an enterprise.

(c) **Substantial ownership / affiliation** means beneficial share holding of 10% (5% for banking companies / DFIs) by a person and/or by his dependent family members.

(d) **Significant influence** refers to the management control of the company, to participate in financial and operating policies, either exercised by representation in the Board of Directors, partnership or by statute / agreement in the policy making process or affiliation or material inter-company transactions.

(e) **Financially interdependent** mean the persons have financial liability with the other in excess of 10% of the equity of the either, or either has guaranteed repayment of loan towards financial institutions.

13. **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.

14. **Medium and Long Term Facilities** mean facilities with maturities of more than one year and Short Term Facilities mean facilities with maturities up to one year.

15. **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.

16. **Other Form of Security** means hypothecation of stock (inventory), assignment of receivables, lease rentals, contract receivables, etc.

17. **PBA** means Pakistan Banks Association.

18. **Readily Realizable Assets** mean and include liquid assets and stocks pledged to the banks / DFIs in possession, with 'perfected lien' duly supported with complete documentation.

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

20. **Subordinated Loan** means an unsecured loan extended to the borrower by its sponsors, subordinate to the claim of the bank / DFI taking exposure on the borrower and documented by a formal sub-ordination agreement between provider of the loan and the bank / DFI. The loan shall be disclosed in the annual audited financial statements of the borrower as subordinated loan.

21. **Small and Medium Enterprise (SME)** means an entity, ideally not a public limited company, which does not employ more than 250 persons (if it is manufacturing concern) and 50 persons (if it is trading / service concern) and also fulfills the following criteria of either 'a' and 'c' or 'b' and 'c' as relevant:
    (a) A trading / service concern with total assets at cost excluding land and building upto Rs 50 million.
    (b) A manufacturing concern with total assets at cost excluding land and building upto Rs 100 million.
    (c) Any concern (trading, service or manufacturing) with net sales not exceeding Rs 300 million as per latest financial statements.

22. **Tangible Security** means readily realizable assets (as defined in these Prudential Regulations), mortgage of land, plant, building, machinery and any other fixed assets.

PART – B
R E G U L A T I O N S

REGULATION R-1
SOURCE AND CAPACITY OF REPAYMENT AND CASH FLOW BACKED LENDING

Banks / DFIs shall specifically identify the sources of repayment and assess the repayment capacity of the borrower on the basis of assets conversion cycle and expected future cash flows. In order to add value, the banks / DFIs are encouraged to assess conditions prevailing in the particular sector / industry they are lending to and its future prospects. The banks / DFIs should be able to identify the key drivers of their borrowers' businesses, the key risks to their businesses and their risk mitigants.

2. The rationale and parameters used to project the future cash flows shall be documented and annexed with the cash flow analysis undertaken by the bank / DFI. It is recognized that a large number of SMEs will not be able to prepare future cash flows due to lack of sophistication and financial expertise. It is expected that in such cases banks / DFIs shall assist the borrowers in obtaining the required information and no SME shall be declined access to credit merely on this ground.

REGULATION R-2
PERSONAL GUARANTEES

All facilities extended to SMEs shall be backed by the personal guarantees of the owners of the SMEs. In case of limited companies, guarantees of all directors other than nominee directors shall be obtained.

REGULATION R-3
LIMIT ON CLEAN FACILITIES

In order to encourage cash flow based lending, banks / DFIs are allowed to take clean exposure, i.e., facilities secured solely against personal guarantees, on a SME up to Rs. 3 million provided that funded exposure should not exceed Rs. 2 million. Before taking clean exposure, banks / DFIs shall obtain a declaration from the SME that it has not availed clean facilities from any other bank/DFI to ensure that the accumulated clean exposure of banks / DFIs on a SME does not exceed the prescribed limit mentioned above.

REGULATION R-4
SECURITIES

Subject to the relaxation in Regulation R-3, for facilities upto Rs 3 million, all facilities over and above this limit shall be appropriately secured as per satisfaction of the banks / DFIs.

<u>REGULATION R-5</u>
MARGIN REQUIREMENTS

The banks / DFIs shall adhere to the margin requirements as prescribed by State Bank of Pakistan from time to time. The current margin requirements are placed at Annexure-I.

<u>REGULATION R-6</u>
PER PARTY EXPOSURE LIMIT

The maximum exposure of a bank / DFI on a single SME shall not exceed Rs 75 million. The total facilities (including leased assets) availed by a single SME from the financial institutions should not exceed Rs 150 million provided that the facilities excluding leased assets shall not exceed Rs 100 million. It is expected that SMEs approaching this limit should have achieved certain sophistication as they migrate into larger firms and should be able to meet the requirements of Prudential Regulations for Corporate / Commercial Banking.

<u>REGULATION R-7</u>
AGGREGATE EXPOSURE OF A BANK / DFI ON SME SECTOR

The aggregate exposure of a bank / DFI on SME sector shall not exceed the limits as specified below:

PERCENTAGE OF CLASSIFIED SMEs ADVANCES TO TOTAL PORTFOLIO OF SMEs ADVANCES	MAXIMUM LIMIT
a. Below 5%	No limit
b. Below 10%	3 times of the equity
c. Below 15%	2 times of the equity
d. Up to and Above 15%	Upto the equity

<u>REGULATION R-8</u>
MINIMUM CONDITIONS FOR TAKING EXPOSURE

While considering proposals for any exposure (including renewal, enhancement and rescheduling / restructuring) exceeding such limit as may be prescribed by State Bank of Pakistan from time to time (presently at Rs 500,000/-), banks / DFIs should give due weightage to the credit report relating to the borrower and his group obtained from a Credit Information Bureau (CIB) of State Bank of Pakistan. However, banks / DFIs may take exposure on defaulters keeping in view their risk management policies and criteria, provided they properly record reasons and justifications in the approval form. The condition of obtaining CIB report will apply to exposure exceeding Rs 500,000/- after netting-off the liquid assets held as security.

2. Banks / DFIs are encouraged to refer the prospective SME borrower to SME Associations for obtaining information about its character and credit

worthiness. The information so obtained may be helpful for banks/DFIs, especially in those circumstances where no information is available from CIB of State Bank of Pakistan.

3. Banks / DFIs shall, as a matter of rule, obtain a copy of financial statements duly audited by a practicing Chartered Accountant, relating to the business of every borrower who is a limited company or where the exposure of a bank / DFI exceeds Rs 10 million, for analysis and record. However, financial statements signed by the borrower will suffice where the exposure is fully secured by liquid assets.

4. Banks / DFIs shall not approve and / or provide any exposure (including renewal, enhancement and rescheduling / restructuring) until and unless the Loan Application Form (LAF) prescribed by the banks / DFIs is accompanied by a 'Borrower's Basic Fact Sheet' under the seal and signature of the borrower as per approved format of the State Bank of Pakistan (Annexure II-A for SMEs other than individuals and Annexure II-B for individual borrowers).

REGULATION R-9
PROPER UTILIZATION OF LOAN

The banks / DFIs should ensure that the loans have been properly utilized by the SMEs and for the same purposes for which they were acquired / obtained. The banks / DFIs should develop and implement an appropriate system for monitoring the utilization of loans.

REGULATION R-10
RESTRICTION ON FACILITIES TO RELATED PARTIES

The bank / DFI shall not take any exposure on a SME in which any of its director, major shareholder holding 5% or more of the share capital of the bank / DFI, its Chief Executive or an employee or any family member of these persons is interested.

R-11
CLASSIFICATION AND PROVISIONING FOR ASSETS

LOANS / ADVANCES

Banks / DFIs shall observe the prudential guidelines given at Annexure-III in the matter of classification of their SME asset portfolio and provisioning there-against.

2. In addition to the time-based criteria prescribed in Annexure-III, subjective evaluation of performing and non-performing credit portfolio shall be made for risk assessment and, where considered necessary, any account including the performing account will be classified, and the category of classification determined on the basis of time based criteria shall be further downgraded. Such evaluation shall be carried out on the basis of credit

worthiness of the borrower, its cash flow, operation in the account, adequacy of the security, inclusive of its realizable value and documentation covering the advances.

3. The rescheduling / restructuring of non-performing loans shall not change the status of classification of a loan / advance etc. unless the terms and conditions of rescheduling / restructuring are fully met for a period of at least one year (excluding grace period, if any) from the date of such rescheduling / restructuring and at least 10% of the outstanding amount is recovered in cash. Further, the unrealized mark-up on such loans (declassified after rescheduling / restructuring) shall not be taken to income account unless at least 50% of the amount is realized in cash. However, this will not impact the de-classification of this account if all other criteria (meeting the terms and conditions for at least for one year and payment of at least 10% of outstanding amount by the borrower) are met. Accordingly, banks / DFIs are directed to ensure that status of classification, as well as provisioning, is not changed in relevant reports to the State Bank of Pakistan merely because a loan has been rescheduled or restructured. However, while reporting to the Credit Information Bureau (CIB) of State Bank of Pakistan, such loans / advances may be shown as 'rescheduled / restructured' instead of 'default'.

Where a borrower subsequently defaults (either principal or mark-up) after the rescheduled / restructured loan has been declassified by the bank / DFI as per above guidelines, the loan will again be classified in the same category it was in at the time of rescheduling / restructuring and the unrealized markup on such loans taken to income account shall also be reversed. However, banks **/** DFIs at their discretion may further downgrade the classification, taking into account the subjective criteria.

At the time of rescheduling / restructuring, banks / DFIs shall consider and examine the requests for working capital strictly on merit, keeping in view the viability of the project / business and appropriately securing their interest etc.

4. Banks / DFIs shall classify their loans / advances portfolio and make provisions in accordance with the criteria prescribed above. Moreover, where banks / DFIs wish to avail the benefit of collateral held against loans / advances, they can consider the value, determined in accordance with the guidelines laid down in Annexure-V, of assets mortgaged / pledged with them, for deduction from the outstanding principal amount of loan / advance against which such assets are mortgaged / pledged, before making any provision. The value of the mortgaged / pledged assets, other than liquid assets, to be considered for this purpose shall be the forced sale value. Further, Forced Sale Value (FSV) once determined, shall remain valid for three years from the date of valuation during which period the underlying collateral will not be revalued for provisioning purpose. The adjustment factors of 80%, 70% and 50% shall be applied on the value so determined for the purpose of determining provisioning requirement in 1st, 2nd and 3rd year of valuation, respectively. Thereafter, the assets shall be revalued and the adjustment factor of 50% shall be applied for all subsequent years. However, the FSV of the collateral shall be restricted to fresh revaluation or previous value,

whichever is less. All valuations conducted during the years 2002 & 2003 shall also be considered 1st year valuations only for the application of adjustment factors referred to above. However, after completion of three years, from the date of last valuation, such assets will also have to be revalued.

For loans which are classified after the issuance of these Prudential Regulations, the benefit will be available for a period of three years going forward up to 80%, 70% & 50% of the FSV for the years 1, 2 & 3 respectively. From year 4, the benefit for provisioning purposes will then remain at 50% of either the previous FSV or the fresh valuation whichever is less. As for loans which are already classified as of the date of issuance of these Prudential Regulation, the banks / DFIs may take benefit of FSV of collateral for the year ended 2003, in accordance with the previous guidelines on the subject. From year 2004, FSVs will be subject to the adjustment factors of 80%, 70% & 50% in 1, 2 & 3 years respectively and then remain at 50% in subsequent years.

To illustrate this new requirement, two scenarios are presented below. Scenario-1 shows the treatment of an existing classified loan and Scenario-2 shows the treatment for an existing satisfactory category loan which becomes classified after the issuance of these Prudential Regulations.

Scenario-1: The collateral has been evaluated in the year 2003 and FSV has been worked out as Rs 300 million. FSV of the collateral has been revalued in the years 2006 & 2009 at Rs 400 million and Rs 450 million respectively, when revaluation is required to be done after completion of three years, if a bank / DFI wishes to avail the benefit of FSV for the purposes of provisioning.

YEAR	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
FSV (in Million)	300	300	300				
Adjustment Factors	None *	80% **	70%				
Benefit for Provisioning	300	240	210				
FSV (Revalued)				400			
Value taken ***				300	300	300	
Adjustment Factors				50%	50%	50%	
Benefit for Provisioning				150	150	150	
FSV (Revalued)							450
Value taken ***							300
Adjustment Factors							50%
Benefit for Provisioning							150

*** In accordance with the previous guidelines on the subject.**
***** Valuations conducted during the year 2002 and 2003 will be considered 1st year valuations for the purposes of application of adjustment factors.**
**** Fresh FSV after three years or previous FSV, which ever is lower.**

Scenario-2: When the property has been evaluated after the year 2004, say in year 2005 and FSV is Rs 200 million and revalued FSV in year 2008 is Rs 250 million. The benefit of the provisioning would be available in the following manner:

YEAR	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
FSV (in Million)		200	200	200			

Adjustment Factors		80%	70%	50%			
Benefit for Provisioning		160	140	100			
FSV – Revalued					250		
Value taken *					200	200	200
Adjustment Factors					50%	50%	50%
Benefit for Provisioning					100	100	100

*** Fresh FSV after three years or previous FSV, which ever is lower.**

5. Banks / DFIs are allowed transition period up to December 31, 2004 to regularize their provisioning position in accordance with the incremental provisioning requirement given at para 4 above

SUBMISSION OF RETURNS:

6. Banks **/** DFIs shall submit the borrower-wise annual statements regarding classified loans / advances to the Banking Inspection Department.

TIMING OF CREATING PROVISIONS:

7. Banks **/** DFIs shall review, at least on a quarterly basis, the collectibility of their loans / advances portfolio and shall properly document the evaluations so made. Shortfall in provisioning, if any, determined, as a result of quarterly assessment shall be provided for immediately in their books of accounts by the banks / DFIs on quarterly basis.

REVERSAL OF PROVISION:

8. The provision held against classified assets will only be released when cash realization starts exceeding;

(i) in case of loss category the net book value of the assets;

(ii) in case of doubtful category 50% of the net book value of the assets; and

(iii) in case of sub-standard category 25% of the net book value of the assets.

Further, the provision made on the advice of State Bank of Pakistan will not be reversed without prior approval of State Bank of Pakistan.

VERIFICATION BY THE AUDITORS:

9. The external auditors as a part of their annual audits of banks / DFIs shall verify that all requirements of Regulation R-11 for classification and provisioning for assets have been complied with. The State Bank of Pakistan shall also check the adequacy of provisioning during on-site inspection.

ANNEXURE-I

MARGIN REQUIREMENTS UNDER REGULATION R-5

A. ADVANCES	MARGIN REQUIREMENT

I. ADVANCES TO MANUFACTURING AND PROCESSING UNITS

Against raw materials and agricultural produces.

i. Raw materials to manufacturing/processing units of capital goods, engineering goods, consumer durable, medicines, cotton yarn, cotton fabrics, jute goods, woolen yarn, cigarettes, fertilizer, pesticides, vegetable ghee and edible oil.	No margin
ii. Raw cotton (both phutti and lint cotton) to ginners.	No margin
Banks are free to determine the basis of valuation of stocks of cotton offered to them as security for credit facilities. However, the stock of cotton may be valued by banks at cost or market value, whichever is lower for advances to cotton ginners. While banks are free to lay down their own lending policies, they are encouraged to also include in their lending policies, for financing against pledge of cotton, the aspect of contamination free cotton as also different grades of cotton and their different prices, for determining the credit limits of their borrowers.	
iii. Paddy and Rice to modern rice mills viz. those rice mills, which have fully automatic machinery and have a husking capacity of not less than five tons of paddy per hour.	No margin
iv. Raw materials to Iron and Steel Industry as well as Ship-Breaking Industry. Ship (unserviceable) for scrapping would constitute raw material for the ship-breaking industry. SBP has no objection to banks accepting ships as collateral at their discretion.	No margin
v. Viscose Fiber to manufacturing units	No margin
vi.	
(a) Raw materials to manufacturing/processing units of goods other than those mentioned above.	25%
(b) Wheat to flour mills. Banks can provide freely finance the procurement of wheat	10 %

by flourmills from any source in Pakistan and without any time restriction on the basis of the annual manufacturing capacity of each flourmill. All finances provided for procurement of wheat shall be interalia, covered against the pledge/hypothecation of wheat stocks.

vii. Red Chillies — Banned

Against finished goods. — 25%

II. ADVANCES TO TRADERS

Against raw materials and agricultural produce

i.	Rice and paddy to entities other than authorized dealers, wheat flour, edible oils (refined, un-refined and hydrogenated) and cotton seeds.	Banned
ii.	Wheat to traders/growers.	15%
iii.	Export of rice registered with Superior Rice Dealers Association, Punjab or Rice Millers and Traders Association Sindh against basmati rice.	No margin
iv.	Cotton.	25%
v.	Fertilizers and pesticides.	No margin
vi.	Rice, paddy and tobacco to authorized dealers.	25%

Advances to authorized dealers against rice and paddy shall be given only against such stocks of paddy/rice, which have been declared to the Food Department / private sector agencies for which they hold receipt from them.

vii.	Other raw materials and agricultural produce.	50%
viii.	Red Chillies.	Banned
ix.	Sugar. • Banks may allow advances to sugar mills and other entities against sugar (both indigenous and imported). Advances against sugar may be valued by banks at cost, or market value whichever is lower.	25%
x.		
	(a) Against finished goods.	75%
	(b) Finished goods manufactured in Pakistan to those traders who are registered with GST/Income Tax Department.	40%

III. OTHER ADVANCES

i.	Shares of listed Companies /TFCs	As per Prudential Regulations for Corporate / Commercial Banking (R-6)
ii.	Bank deposits and deposit certificates. • 25% margin is applicable to all forms of certificates including certificates issued under National Saving Scheme such as (a) Special Saving Certificate (b) Khas Deposits Certificates (c) Defense Saving Certificates (d) NDFC Bearer Certificates (e) Foreign Exchange Bearer Certificates (f) Any other Government backed securities. • Value of such certificates, sum payable on date of presentation will be taken for making advances by the banks. • Prize Bonds being issued by Government needs to be given same treatment as that of other securities issued by Government. As such banks can provide financing facilities against Prize Bonds at 25% margin or a margin of 1.5 times of accrued markup on annual basis which ever is higher. However, as the value remains stagnant (on account of lack of interest payments) financing provided against those Prize Bonds should be for one year.	25%
iii.	For financing goods, including production machinery, commercial Vehicles and consumer durables on hire purchase or installments plan.	No margin
iv.	Against banned imports.	Banned
v.	Real Estates.	No margin
vi.	Ships.	No margin

State Bank has no objection to banks accepting ships as collateral at their discretion.

IV. CLEAN ADVANCES AND ADVANCES SECURED BY GUARANTEES

(There are no margin restrictions applicable in the case of bank guarantees; however, banks may exercise their own discretion in the matter if necessary.)

- **Clean advances** or advances secured by guarantee: - As per Prudential Regulation R-3

i. **Agricultural loan against guarantee/securities** under the scheme for Agricultural Loan by Commercial Banks circulated vide ACD Circular No.5/72 dated 27-11-1972 and Circular Letter No.ACD./1035-1039/PD(P)-08/2001 dated 25-04-2001as amended from time to time, can be granted to maximum amount of Rs.100, 000/= and that total guarantee of one guarantor/person should not in any case exceed Rs.500, 000/- excepting a processing unit.

ii. **Rupee finance.** Banks can grant rupee loans to their clients (including foreign controlled companies) against guarantees of non-residents/guarantees received from banks functioning abroad subject to the conditions as prescribed under Prudential Regulations and such other instructions issued by SBP from time to time.

V. ADVANCES FOR EXPORTS

The restrictions relating to grant of clean advances or minimum margin requirements shall not apply to:

i. Advances granted to finance export under irrevocable letters of credit or firm orders upto the amount for which credit is opened or firm order made.

ii. Packing credit for export; and

Pre-shipment credit granted for financing export of goods covered by firm contract made, or irrevocable letters of credit opened by foreign importers in favor of exporters in Pakistan, provided that the advances do not exceed the amount specified in the contract or the credit, as the case may be.

B. IMPORT LETTERS OF CREDIT

There is no mandatory minimum margin requirements for opening of import letter of credit except Caustic Soda (PCT heading 2815:1200) which will be subject to 100% cash margin.

ANNEXURE II-A

BORROWER'S BASIC FACT SHEET- FOR SMEs OTHER THAN INDIVIDUALS
PRESCRIBED UNDER REGULATION R-8

Date of Request.________________

(TO BE COMPLETED IN CAPITAL LETTERS OR TYPEWRITTEN)

1. BORROWER'S PROFILE:

Name				Address	
Phone #			Fax #	E-mail Address	
Office	Res.				
National Identity Card #			National Tax #		Sales Tax #
Import Registration #	Export Registration #	Date of Establishment		Date of opening of A/c.	

2. DETAILS OF DIRECTORS/OWNERS/PARTNERS:

Name		Address	
Phone #		Fax #	E-mail Address
Office	Res.		
National Identity Card #			National Tax #
Share-holding	Amount		% of Share-holding

3. MANAGEMENT:

A) EXECUTIVE DIRECTORS/PARTNERS:			
Name	**Address**	**NIC #**	**Phone #**
1.			
2.			
B) NON-EXECUTIVE DIRECTORS/PARTNERS:			
Name	**Address**	**NIC #**	**Phone #**
1.			
2.			

4. CORPORATE STATUS:

Sole Proprietorship	Partnership	Public / Private Limited Company

5. NATURE OF BUSINESS:

Industrial	Commercial	Agricultural	Services	Any other

6. REQUESTED LIMITS:

	Amount	Tenor
Fund Based		
Non-Fund Based		

7. BUSINESS HANDLED/EFFECTED WITH ALL FINANCIAL INSTITUTIONS DURING THE LAST ACCOUNTING YEAR:

Imports	Exports	Remittances effected (if any)

8. EXISTING LIMITS AND STATUS:

	Amount	Expiry Date	Status	
			Regular	Amount Overdue (if any)
Fund Based				
Non-Fund Based				

9. ANY WRITE-OFF, RESCHEDULING/ RESTRUCTURING AVAILED DURING THE LAST THREE YEARS:

Name of Financial Institution	Amount during 1^{st} Year		Amount during 2^{nd} Year		Amount during 3^{rd} Year	
	Write-off	Rescheduled/ Restructured	Write-off	Rescheduled/ Restructured	Write-off	Rescheduled/ Restructured

10. DETAILS OF PRIME SECURITIES MORTGAGED/ PLEDGED:

A) AGAINST EXISTING FACILITIES:

Name of Financial Institution	Nature of Security	Total Amount	Rank of Charge	Net Realizable Value
1.				
2.				

B) AGAINST REQUESTED/ FRESH/ ADDITIONAL FACILITIES:

Name of Financial Institution	Nature of Security	Total Amount	Net Realizable Value
1.			
2.			

11. DETAILS OF SECONDARY COLLATERAL MORTGAGED/ PLEDGED:

A) AGAINST EXISTING FACILITIES:

Name of Financial Institution	Nature of Security	Total Amount	Rank of Charge	Net Realizable Value
1.				
2.				

B) AGAINST REQUESTED/ FRESH/ ADDITIONAL FACILITIES:

Name of Financial Institution	Nature of Security	Total Amount	Net Realizable Value
1.			
2.			

12. CREDIT RATING (WHERE APPLICABLE):

Name of Rating Agency	Rating

13. DETAILS OF ASSOCIATED CONCERNS (AS DEFINED IN COMPANIES ORDINANCE, 1984):

Name of Concern	Name of Directors	Share-holding	% of Total Share Capital

14. FACILITIES TO ASSOCIATED CONCERNS BY THE CONCERNED FI:

Name of Concern	Nature & Amount of Limit	Outstanding as on--------	Nature & Value of Securities	Overdues	Defaults

15. DETAILS OF PERSONAL GUARANTEES PROVIDED BY THE DIRECTORS / PARTNERS ETC. TO FIs TO SECURE CREDIT:

Names of the Guarantors	Institutions/persons to whom Guarantee given	Amount of Guarantee	Validity Period	NIC #	NTN	Net-worth

16. DIVIDEND DECLARED (AMOUNT) DURING THE LAST THREE YEARS:

During 1st Year	During 2nd Year	During 3rd Year

17. SHARE PRICES OF THE BORROWING ENTITY:

Listed Company		Break-up Value of the Shares in case of Private Limited Company
Current Price	Preceding 12 Months Average	

18. NET-WORTH (PARTICULARS OF ASSETS OWNED IN THEIR OWN NAMES BY THE DIRECTORS/PARTNERS/PROPRIETORS):

Owner's Name	Particulars of Assets	Market value	Particulars of Liabilities

19. DETAILS OF ALL OVERDUES (IF OVER 90 DAYS):

Name of Financial Institution	Amount

20. Details of payment schedule if term loan sought.

21. Latest Audited Financial Statements as per requirements of Regulation R-8 to be submitted with the LAF (Loan Application Form).

22. Memorandum and Articles of Association, By-laws etc. to be submitted by the borrower alongwith the request

I certify and undertake that the information furnished above is true to the best of my knowledge.

CHIEF EXECUTIVE'S/ BORROWER'S
SIGNATURE & STAMP

COUNTER SIGNED BY:

AUTHORISED SIGNATURE & STAMP
(BANK / DFI OFFICIAL)

ANNEXURE II-B

BORROWER'S BASIC FACT SHEET - FOR INDIVIDUALS
PRESCRIBED UNDER PRUDENTIAL REGULATION R-8

Date of Request._______________

(TO BE COMPLETED IN CAPITAL LETTERS OR TYPEWRITTEN)

1. BORROWER'S PROFILE:

<table>
<tr><th colspan="2">Name</th><th colspan="2">Address</th></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
<tr><th colspan="2">Phone #</th><th>Fax #</th><th>E-mail Address</th></tr>
<tr><td>Office</td><td>Res.</td><td></td><td></td></tr>
<tr><th colspan="3">National Identity Card #</th><th>National Tax #</th></tr>
<tr><td colspan="3"></td><td></td></tr>
<tr><th>Father's Name</th><th colspan="3">Father's National Identity Card #</th></tr>
<tr><td></td><td colspan="3"></td></tr>
</table>

2. REFERENCES (AT LEAST TWO):

<table>
<tr><th colspan="2">Name</th><th colspan="2">Address</th></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
<tr><th colspan="2">Phone #</th><th>Fax #</th><th>E-mail Address</th></tr>
<tr><td>Office</td><td>Res.</td><td></td><td></td></tr>
<tr><th colspan="3">National Identity Card #</th><th>National Tax #</th></tr>
<tr><td colspan="3"></td><td></td></tr>
</table>

3. NATURE OF BUSINESS/ PROFESSION:

Industrial	Commercial	Agricultural	Services	Any other

4. EXISTING LIMITS AND STATUS:

<table>
<tr><th rowspan="2"></th><th rowspan="2">Amount</th><th rowspan="2">Expiry Date</th><th colspan="3">Status</th></tr>
<tr><th>Regular</th><th>Amount Over-due (if any)</th><th>Amount Rescheduled/ Restructured (if any)</th></tr>
<tr><td>Fund Based</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Non-Fund Based</td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

5. REQUESTED LIMITS:

	Amount	Tenor
Fund Based		
Non-Fund Based		

6. Details of payment schedule if term loan sought.

7. Latest Income Tax / Wealth Tax Form to be submitted by the borrower.

I certify and undertake that the information furnished above is true to the best of my knowledge.

____
APPLICANT'S SIGNATURE & STAMP

COUNTER SIGNED BY:

____
AUTHORISED SIGNATURE & STAMP
(BANK / DFI OFFICIAL)

ANNEXURE-III

GUIDELINES IN THE MATTER OF CLASSIFICATION
AND PROVISIONING FOR ASSETS (REGULATION R-11)

(I) SHORT TERM FINANCING FACILITIES:

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE
(1)	(2)	(3)	(4)
1. OAEM (Other Assets Especially Mentioned).	Where mark-up/ interest or principal is overdue (past due) by 90 days from the due date.	Unrealized mark-up/ interest to be put in Suspense Account and not to be credited to Income Account except when realized in cash.	No Provision is required.
2. Substandard.	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 20% 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 adjusted forced sale value of mortgaged/ pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
3. Doubtful.	Where mark-up/ interest or principal is overdue by one year 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

			adjusted forced sale value of mortgaged/ pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
4. Loss.	(a) Where mark-up/ interest or principal is overdue beyond two years 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 adjusted forced sale value of mortgaged/ pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
	(b) Where Trade Bills (Import/Export or Inland Bills) are not paid/adjusted within 180 days of the due date.	As above.	As above.

(II) <u>MEDIUM AND LONG TERM FINANCING FACILITIES</u>:

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE
(1)	**(2)**	**(3)**	**(4)**
1. OAEM (Other Assets Especially	Where mark-up/ interest or principal is	Unrealized mark-up/ interest to be put in Suspense	No Provision is required.

	Mentioned).	overdue (past due) by 90 days from the due date.	Account and not to be credited to Income Account except when realized in cash.	
2.	Substandard.	Where installment of principal or interest/ mark-up is overdue by one year or more.	As above.	Provision of 20% 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 adjusted forced sale value of mortgaged/ pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
3.	Doubtful.	Where installment of principal or interest/ mark-up is overdue by two years or more.	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 adjusted forced sale value of mortgaged/ pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.

4. Loss.	Where installment of principal or interest/ mark-up is overdue by three years or more.	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 adjusted forced sale value of mortgaged/ pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.

Note:

Classified loans / advances that have been guaranteed by the Government would not require provisioning, however, markup / interest on such accounts shall be taken to suspense account instead of income account.

ANNEXURE-IV

UNIFORM CRITERIA FOR DETERMINING THE VALUE
OF ASSETS MORTGAGED / PLEDGED (REGULATION R-11)

Only assets having registered mortgage, equitable mortgage (where NOC for creating further charge to another bank **/** DFI / NBFC has not been issued by bank / DFI) and pledged assets shall be considered. Assets having pari-passu charge shall be considered on proportionate basis of outstanding amount.

2. Hypothecated assets and assets with second charge and floating charge shall not be considered.

3. Valuations shall be carried out by an independent professional valuer who should be listed on the panel of valuers maintained by the Pakistan Banks' Association (PBA) for this purpose. PBA shall lay down the minimum eligibility criteria with the prior approval of the State Bank of Pakistan for placement of valuers on the panel to be maintained by it. The valuer while assigning any values to the mortgaged / pledged assets, shall take into account all relevant factors affecting the salability of such assets including any difficulty in obtaining their possession, their location**,** condition and the prevailing economic conditions in the relevant sector, business or industry. The values of mortgaged / pledged assets so determined by the valuers must have to be a reasonably good estimate of the amount that could currently be obtained by selling such assets in a forced / distressed sale condition. The valuers should also mention in their report the assumptions made, the calculations / formulae / basis used and the method adopted in determination of the values.

4. Full Scope Valuation shall be done at least once in three years. For example any valuation done on November 01, 1999 would be valid for consideration for the accounting periods ending on December 31, 1999, December 31, 2000 and December 31, 2001, thus for subsequent accounting periods, a fresh valuation would be required. The valuation process will include conducting a 'Full-Scope Valuation' of the assets in the first year and then followed by 'Desktop Valuations' in the second and third year. Evaluators on the panel of the PBA will be eligible to conduct only two Full Scope valuations consecutively of a company, as such the companies being evaluated will require to change evaluator after two consecutive Full Scope valuations i.e. for a full period of six years.

5. State Bank may check the valuations of the mortgaged assets through an independent evaluator, on random basis, to verify the reasonableness of the valuations. The unjustified differences in the valuations of the banks / DFIs and State Bank of Pakistan shall render the concerned bank / DFI and evaluator to penal actions.

6. The categories of mortgaged / pledged assets to be considered for valuation along with discounting factors to be applied would be as under (no other assets shall be taken into consideration):

a) Liquid Assets:
Valuation of Liquid Assets shall be determined by the bank / DFI itself and verified by the external auditors. However, in the case of pledged shares of listed companies, values should be taken at market value as per active list of Stock Exchange(s) on the balance sheet date and as per guidelines given in the TR-23 issued by the Institute of Chartered Accountants of Pakistan (ICAP). Moreover, valuation of shares pledged against loans/advances shall be considered only if these have been routed through Central Depository Company of Pakistan (CDC), otherwise these will not be admissible for deduction as liquid assets while determining required provisions.

b) Land and Building:
Valuation of land and buildings would be accepted as determined by the valuers in accordance with the criteria given above and no further discounting factor would be applied on forced sale value determined by them.

c) Plant and Machinery:
Entities of classified borrowers shall be divided into following categories at the balance sheet date and discounting factors shall be applied to forced sale value as under:

Category	Discounting factors to be applied to forced sale value
A) In operation.	No discounting factor to be applied.
B) In operation at the time of valuation but now closed / in liquidation.	• 15% of forced sale value on the date of closure. • 1^{st} year after closure-25% of forced sale value • 2^{nd} year-50% of forced sale value.
C) Closed / in liquidation at the time of valuation and no change in situation.	• After valuation-1^{st} year 25% of forced sale value. • 2^{nd} year-50% of forced sale value.

d) Pledged Stocks:
In case of pledged stocks of perishable and non-perishable goods, forced sale value should be provided by valuers, which should not be more than one year old, at each balance sheet date. The goods

should be perfectly pledged, the operation of the godowns should be in the control of the bank / DFI and regular valid insurance and other documents should be available. In case of perishable goods, the valuer should also give the approximate date when these are expected to be of no value.