

## Enclosures to BPD Circular No. 28 dated August 23, 2003

### GUIDELINES ON COMMERCIAL PAPER

#### 1. DEFINITIONS:

Following definitions of the terms used in the circular will prevail for the purpose of this circular:

- (i). **Banking Company:** means a banking company as defined in the Banking Companies Ordinance, 1962.
- (ii). **Commercial Paper (CP):** means an unsecured promissory note with a maturity of not less than 30 days and not more than 9 months.
- (iii). **Commission:** means the Securities and Exchange Commission of Pakistan (SECP).
- (iv). **Company:** means a company as defined in the Companies Ordinance, 1984.
- (v). **Custodian:** means a person who will maintain a register of investors and their CP holdings.
- (vi). **DFIs:** mean Development Financial Institutions viz. Pak Libya Holding Company Limited, Saudi Pak Industrial and Agricultural Investment Company Limited, Pakistan Kuwait Investment Company Limited, Pak-Oman Investment Company (Pvt.) Limited and Pakistan Industrial Credit and Investment Corporation.
- (vii). **Financial Institution:** means financial institution as defined in the Financial Institutions (Recovery of Finances) Ordinance, 2001.
- (viii). **Investment Bank:** means an investment finance company as defined in the Non-Banking Finance Companies (Establishment and Regulation) Rules 2003.
- (ix). **Investors:** mean the persons that will purchase the CP.
- (x). **Issuer :** means a company (other than a Banking Company and DFI) that intends to raise short term finance by issuing CP in terms of the SECP guidelines dated 28<sup>th</sup> October 2002.
- (xi). **Issuing and Paying Agent (IPA):** means a scheduled bank, investment bank or DFI that will deliver the CP to investors against the proof of payment and at maturity, having received funds from the issuer, will effect repayment on receipt of the CP back from the investors.
- (xii). **Provider of Credit Enhancement:** means a financial institution, which provides guarantees or undertakings to the investors in the CP.
- (xiii). **Scheduled Bank:** means scheduled bank as defined in the State Bank of Pakistan Act, 1956.
- (xiv). **Standby Facility:** means a credit line sanctioned by a bank/DFI to the Issuer, meant only to provide liquidity at the time of the maturity of CP, but not intended to eliminate or reduce the credit risk of CP in any manner.
- (xv). **Underwriter:** means a financial institution that undertakes to purchase the unsold portion of the issue not wholly subscribed by the investors.
- (xvi). **Working Capital Limit:** means the aggregate fund-based limits including those by way of purchase/discount of bills sanctioned by one or more financial institutions to a company for meeting its working capital requirements. And also includes working capital term finance limits.

All other words and expressions used but not defined in these guidelines shall have the same meanings as are assigned to them in the Banking Companies Ordinance, 1962.

#### 2. GENERAL GUIDELINES:

- (i) Banks/DFIs shall not deal in any manner and in any capacity in commercial papers (CPs) of denomination below Rs 1 million.
- (ii) While it is encouraged that the CP should be in a scriptless form, there is no bar on dealing with CP in script form as well.

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- (iii) All the endorsements made by the banks/DFIs to the subsequent purchasers of their holding of CPs shall be strictly on "without recourse basis".
- (iv) While underwriting the issue, banks/DFIs shall ensure that their total exposure including underwriting does not exceed their per party exposure limits prescribed in these guidelines and under Prudential Regulations. In order to facilitate the banks in this respect, underwriting commitment shall be assigned a weightage of 50% for the purpose of calculating per party exposure limit. While the Banks/DFIs are required to take due care to ensure that their per party limits are not breached, even if they have to take up their committed share of issue, a maximum four weeks warehousing period is, however, allowed to sell down the CPs in excess of their per party limits, in case breach occurs

despite the best efforts of the banks/DFIs on account of taking up the share of their underwriting commitment.

- (v) Banks/DFIs shall not provide any fund based or non-fund based facility against the security of Commercial Paper.

### **3. ISSUING AND PAYING AGENT (IPA):**

Banks & DFIs are eligible to perform the role of IPA provided that:

- (i). They meet the minimum capital requirement of SBP and have a minimum credit rating of A- (medium to long term) and A2 (short term) from the credit rating agencies approved by SBP or from Standard & Poor, Moodys or Fitch.
- (ii). They ensure that all the regulatory requirements as prescribed by SECP and SBP are duly met by the issuer before the issue can be taken up by the prospective investors/dealers.
- (iii). They have in place written internal guidelines (operational procedures) duly approved by their Board of Directors for dealing with commercial papers in the capacity of IPA.
- (iv). They open a separate escrow account for receiving and disbursing funds on account of CP.
- (v). They make it clear to the investors in the offering document that their investment is subject to credit and other risks inherent in such instruments and payment will be made to them only if the issuer has made the funds available to IPA.
- (vi). They inform the prospective investors that in case of default, the IPA will not be in a position to seek recovery from the issuer or initiate any action against the issuer either on its own or on behalf of the investors.
- (vii). In case of default by the issuer, it will be the responsibility of the bank/DFI acting as IPA to notify promptly such default to the investors. For the purpose of these guidelines, payment of only partial amount shall also be considered default.
- (viii). In case of partial payment by the issuer, bank/DFI acting as IPA shall distribute the received funds as per terms of the underlying agreements.

### **4. CUSTODIAN**

At the discretion of the issuer and IPA, investors may be required to invariably inform the custodian about the sale/purchase to make the transfer effective. If a bank / DFI desires to perform the role of custodian, it should comply with the following guidelines:

- (i) The bank / DFI desirous of performing the role of custodian would develop operational procedures (manual) for this purpose.
- (ii) The bank / DFI shall take necessary steps and all reasonable measures to protect them from the risk of frauds and forgeries and consequent obligations arising thereto.

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### **5. INVESTORS**

- (i) The banks/DFIs shall invest in only those CPs:
  - a) Which have been issued in pursuance of SECP's guidelines for the issue of Commercial Paper and meet all the requirements laid down by State Bank of Pakistan.
  - b) Where the equity of the issuer is not less than Rs. 100 million.
  - c) Where the current and debt-equity ratios of the issuer do not fall below 1:1 and 60:40. For this purpose, the numbers of the last audited accounts of the issuer will be applicable.
  - d) Where the issuer does not have any overdue or default as evidenced by a report received from Credit Information Bureau of State Bank of Pakistan. The CIB report obtained by the bank/DFI for this purpose should not be more than two months old.
  - e) Where the current credit rating of the issuer, rated by a credit rating agency approved by State Bank of Pakistan, should not be below "A-" (long term) and "A2" (short term).
  - f) Where the IPA is either a scheduled commercial bank, DFI or an investment bank with a minimum credit rating of A- (long term) and A2 (short term) from a credit rating agency approved by State Bank of Pakistan.
  - g) Where the total borrowings of the issuer by way of CPs do not exceed its equity (paid up capital and reserves).
- (ii) The banks/DFIs investing in CP shall ensure that their total exposure, including investment in commercial papers, at all time remains within the per party exposure limit prescribed under Prudential Regulations.
- (iii) The bank/DFI's investment in CPs of an issuer shall not exceed 10% of the equity (paid-up capital and reserves) of the bank/DFI.
- (iv) The bank/DFI's investment in a single issue of CP shall not exceed 25% of the size of the issue. In case a bank/DFI intends to take up the whole issue or invest more than the limit of 25%, at the time of issue of CP, for subsequent sell down in the market, it shall be required to dispose off the CPs in excess of above limit in the following manner:
  - a) Within 20 days where tenure of CP is 90 days or more
  - b) Within 15 days where tenure of CP is 60 days or more but less than 90 days
  - c) Within 10 days if tenure of CP is less than 60 days.
- (v) The total investment of the bank/DFI in CPs shall not exceed twice the equity of the bank/DFI. The banks/DFIs shall ensure compliance with all the limits prescribed herewith and Prudential Regulations.
- (vi) The banks/DFIs wishing to invest in CP's shall obtain one time prior approval from State Bank for commencing / undertaking this activity.

### **6. PROVIDER OF CREDIT ENHANCEMENT AND STANDBY FACILITIES**

- (i) As the CP shall be an unsecured instrument, banks will not provide any guarantee, undertaking etc. that may give an impression to the prospective investors that the bank stands behind such issue.
- (ii) Banks/DFIs may allow standby facility to the issuer provided that the facility is fully secured against realizable securities before the disbursement is made.

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**7. STANDARD DOCUMENTATION**

In order to bring uniformity and standardization, PBA shall prepare standardized documents (such as the model format of Commercial Paper, IPA agreement, Dealership agreement, Mandate Letter, Transfer Memo, etc.) in the light of guidelines issued by SBP and SECP for use of banks/DFIs. However, banks/DFIs

may continue to use documents as suggested by their legal counsels till such time the standardized documents are made available.

**8. CLARIFICATION**

In case of any conflict/inconsistency, the guidelines on Commercial Paper issued by State Bank of Pakistan shall take precedence over the ones issued by SECP in this respect.

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