BPRD Circular No.9 April 27, 2000

All Banks/NBFIs

Dear Sirs,

PRUDENTIAL REGULATION – VIII / NBFIs RULE 14 FOR CLASSIFICATION AND PROVISIONING.

Prudential Regulation VIII for banks and NBFIs Rule 14 for NBFIs regarding classification and provisioning are hereby subsituated as under:

CLASSIFICATION AND PROVISIONING FOR ASSETS:

Every bank/NBFI shall observe prudential guidelines given hereunder in the matter of classification of its assets portfolio and provisioning thereagainst.

LOAN/ADVANCES;

(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 Amount 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 realisable without recourse to a Court of Law and forced sale value of mortgaged/pledged assetas as valued by valuers fulfilling prescribed eligibility criteria in accordance with the guidelines provided in this Circular.

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 realisable without recourse to a Court of Law and forced sale value of mortgaged/pledged assets as valued by values fulfilling prescribed eligibility criteria in accordance with the guidelines provided in this Circular.
4. Loss.	(a) Where mark-up/interest or principal is overdue beyond two years or more from the due date (b) Where Trade Bills (Import/export or inland bills) are not paid/adjusted within 180 days of the due date.	As above As above.	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realisable without recourse to a Court of Law and forced sale value of mortgaged/pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this Circular. As above.

(II) LONG 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 installment of	As above.	Provision of 20% of the

	principal or interest/mark-up is overdue by one year or more.		difference resulting from the ourstanding balance of prinbcipal less the amount of liquid assets realisable without recourse to a Court of Law and forced sale value of mortgaged/pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this Circular.
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 realisable without recourse to a Court of Law and forced sale value of mortgaged/pledged assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this Circular.
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 forced sale value of mortgaged/pledged assets as valued by valuers by valuers fulfilling prescribed eligibility criteria, in

			accordance with the guidelines provided in this Circular.

Note:

(a) Liquid assets mean realizable amount of bank deposits, certificates of deposit, government securities, shares of listed companies, NIT units, certificates of mutual funds, gold ornaments, inventories pledged to banks/NBFIs with possession with 'perfected lien' duly supported with flawless documentation.

(b) Classified loans/advances that have been guaranteed by the Federal Government would not require provisioning, however, mark-up/interest on such accounts shall be taken to suspense account instead of income account.

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2) In addition to the above time based criteria, subjective evaluation of performing and non-performing credit portfolio shall be made for risk assessment and where considered necessary 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 adequacy of security inclusive of its realizable value, cash flow of borrower, his operation in the account, documentation covering advances and credit worthiness of the borrower, etc.

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. Accordingly, banks/NBFIs are directed to ensure that status of classification as well as provisioning is not changed in relevant reports to the State Bank merely because of the fact that a loan has been restructured or rescheduled. However, while reporting to the CIB, such loans/advances may be shown as "rescheduled/restructured" instead of "default".

4) Banks/NBFIs will continue to classify their loans/advances portfolio and make provision there against in accordance with the time based criteria prescribed above. However, where a bank/NBFI wishes to avail of the benefit of collaterals held against loans/advances they can consider the realizable value of assets mortgaged/pledged for deduction from the outstanding principal amount of loan/advance against which such assets are mortgaged/pledged, before making any provisions. The realizable value shall be the value that could currently be obtained by selling the mortgaged/pledged asset in a forced/distressed sale conditions. Accordingly, banks/NBFIs shall take into account only forced sale value into consideration while determining the required provisions. Loans/ Advances against which securities are not available, or which have not been valued according to these guidelines and verified by the external auditors, shall continue to be classified and provided for according to the time-based criteria. Banks/NBFIs shall follow the following uniform criteria for determining the realizable value of assets mortgaged /pledged :

i. Only assets having registered mortgage, equitable mortgage (where NOC for creating further charge has not been issued by bank/NBFI) and pledged assets shall be considered. Assets having pari passu charge shall be considered on proportionate basis.

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

iii. 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 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 saleability of such assets including any difficulty in obtaining their possession, their location and condition and the prevailing economic conditions in the relevant sector, business or industry. The realizable 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 realisable values.

iv. iv) Valuation shall be done at least once in three years. For example any valuation done on Ist November, 1999 would be valid for consideration for the accounting periods ending on December 31, 1999, December 31, 2000 and December 31, 2001 and for subsequent accounting periods a fresh valuation would be required. If valuation is older than three years as explained above, a re-valuation should be done, otherwise the valuation shall be taken as nil.

v. v) 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, excluding pledged stocks which are dealt with at (d) below, shall be determined by the bank 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 on the balance sheet date and as per guidelines given in the TR-23 issued by the Institute of Chartered Accountants of Pakistan. Moreover, valuation of shares pledged against loans/ advances after issuance of this circular 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) <u>Land and Building</u> :

Valuation of land and buildings would be accepted as determined by the valuers in accordance with the criteria given at Point 4(iii) above and no further discounting factor would be applied on forced sale value determined by them.

c) <u>Plant and Machinery</u> :

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
In operation	No discounting factors to be applied
In operation at the time of valuation but now closed/in liquidation	• 15% of forced sale value on the date of closure. • 1st year after closure –25% of forced sale value. • 2nd year –50% of forced sale value
Closed/in liquidation at the time of valuation and no change in situation	• After valuation –1st year 25% of forced sale value. • 2nd year –50% of forced sale value

d) **Pledged Stocks** :

In case or pledged stocks of perishable and non-perishable goods, forced sale value should be provided by valuers, which should not be more than six months 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 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.

vi. For valuations of mortgaged assets carried out within a period of twelve months prior to December 31, 1999, these may be considered provided they were carried out by an independent professional valuer and a revised certificate is obtained from the valuer regarding the forced sale value of the assets as on the date the valuation was carried out. These valuations should then be subject to the discounting percentages and other criteria as laid down in this Circular.

vii. The values of mortgaged/pledged assets determined by the valuers shall be subject to verification by the external auditors, who may reject cases of valuation, which in their opinion, do not appear to have been professionally carried out and values determined are unreasonable, or in the case of which valid documentation of mortgage/pledge, supported by legal opinion wherever required, is not available on record.

INVESTMENTS AND OTHER ASSETS:

5) Subjective evaluation of investment portfolio and other assets shall be carried out by the bank/NBFI. Classification of such assets and provision required there against shall be determined keeping in view the risk involved and the requirements of the International Accounting Standards.

SUBMISSION OF RETURNS:

6) Besides submitting the party-wise annual statements regarding classified loans/advances to our Banking Supervision Departments, as is being done currently, banks/NBFls shall submit a yearly statement giving consolidated position of their classified assets and provisions required there against to Banking Policy and Regulations Department as per Annexure-l, within three
months of the close of their accounting year .

TIMING OF CREATING PROVISIONS:

7) Banks/NBFIs 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 the quarterly assessment shall be provided for immediately in their books of accounts by the banks/NBFIs. This process shall be started from the quarter ending 30th June, 2000.

VERIFICA TION BY THE AUDITORS:

8) The external auditors as a part of their annual audits of banks/NBFIs shall verify that all requirements of Prudential Regulation VIII/NBFIs Rule 14 in classification of assets and determination of provisions required there against have been complied with. The State Bank shall also check the adequacy of provisioning during on-site inspection.

Please acknowledge receipt.

Yours faithfully,

sd/-

(KAZI ABDUL MUKTADIR)
DIRECTOR

ANNEXURE-I
(BP&RD CIRCULAR NO. 9 Dated 27-04-2000)

NAME OF THE BANK/NBFI---

STATEMENT OF CLASSIFIED ASSETS AND PROVISIONING THEREAGAINST AS OF THE YEAR ENDED 31st Dec,/30th June-----------------

1.QUALITY OF ADVANCES:

	CATEGORY OF CLASSIFICATION				
	OAEM	**SUB-STANDARD**	**DOUBTFUL**	**LOSS**	**TOTAL**
Principal amount of classified loans/advance (I)					
Less: a) Valuve of liquid assets					
b) Discounted realizable value of mortgaged/pledged assets in forced/distressed sale conditions.					
Sub-Total (ii) = (a+b)					
Net amount on which provision is required to be calculated (iii)=I-ii					
Provisioning requirement:					
Percentage (iv)	0%	20%	50%	100%	
Amount (v) =iii*iv					

2-**QUALITY OF ASSETS:**

	Loans/advances	Investments	Other Assets	Total Assets
Gross Assets (vi)				
Amount classified: c) OAEM d) Sub-standard e) Doubtful f) Loss				
Total Classified (vii)=c+d+e+f				
Provision required (viii)				
Provision held: g) At beginning of year h) Addition/reversal during the year At end of accounting year (ix) = g+/-h				
Excess/shortfall in provision (x)=ix-viii				
Infection Ratio (ix)=(vii/vi)*100				

Authorised Signatory

Date----------------

Name & Designation------------------------
Seal/Stamp of Bank-------------------------