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**LOANS, OVERDRAFTS AND GUARANTEES**

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**Part A – Rupee Loans**

1. Regulations governing Loans and Guarantees.
2. Definition of Foreign Controlled Companies.
3. General permission for lending to Foreign Controlled Companies for working capital.
4. Local Borrowings for Capital Expenditure.
5. Borrowings by Individual Foreign Nationals.
6. Loans and Overdrafts to Non-Residents including Loans for Purchase of Residential Plots/Houses/Flats by Overseas Pakistanis.
7. Loans and Overdrafts against Guarantees of Non-Residents or against Collateral held outside Pakistan.

**Part B- Foreign Private Loans**

8. Private Foreign Currency Loans.
9. Pay-As-You-Earn (PAYE) Scheme.
10. Features of the Scheme.
11. Procedure for import of machinery and registration of repayment schedule.
12. Re-payment under Pay-As-You-Earn Scheme.
13. Payment of Penalty-Head of Account.
14. Re-payments under loans/credits other than PAYE Loans.
15. Repatriable Foreign Currency Loans by Foreign Controlled Companies.
16. Foreign Currency Loans For Financing Exports.
17. Foreign Currency Loans for Working Capital and other purposes.

18. Short term Borrowings in Foreign Currency by Authorized Dealers.
19. Long Term Borrowings in Foreign Currency by Authorized Dealers.
20. Loans and Advances by Authorized Dealers in Foreign Currency.
21. Special FCY Borrowing by Micro Finance Banks/Institutions(MFB/Is).

**Part C- Guarantees etc.**

22. Guarantees on behalf of Foreign Controlled Companies.
23. Guarantees on behalf of Residents of Pakistan in favour of Non-Residents.
24. Guarantees on behalf of Non-Residents in favour of Residents of Pakistan.
25. Performance/Bid Bond Guarantees.
26. Remittances under Guarantees or Performance Bonds and their Reporting to the State Bank.
27. Opening of Letters of Credit and Advising of Negotiations under Export Letters of Credit.
28. Guarantees which may be given without Prior Approval.
29. Guarantees and Collaterals in favour of Overseas Bank Branches and Correspondents.
30. Renewal of Loans and Overdrafts.

## **CHAPTER 19**

### **LOANS, OVERDRAFTS AND GUARANTEES**

#### **Part A – Rupee Loans**

##### **1. Regulations governing Loans and Guarantees.**

Extension of loans, overdrafts and credit facilities to companies (other than Banking Companies) which are by any means controlled directly or indirectly by persons resident outside Pakistan and to residents against guarantees or collaterals lodged outside Pakistan, obtaining of loans and overdrafts in foreign currencies and giving of guarantees on behalf of residents of Pakistan in favour of non-residents or on behalf of non-residents in favour of residents, are regulated under sub-section (2) of Section 18 and Sections 4 and 5 of the Act. This chapter contains the general regulations covering grant of such loans, overdrafts, credit facilities and guarantees.

##### **2. Definition of Foreign Controlled Companies.**

Section 18(2) of the Act imposes restrictions on lendings to any company, not being a banking company, which is by any means controlled, whether directly or indirectly, by persons resident outside Pakistan. For the purposes of this section a company, which term includes a firm, branch or office of a company or firm, is deemed to be controlled directly or indirectly by persons resident outside Pakistan, if

- (i) it is a branch office of a company incorporated outside Pakistan, or
- (ii) in the case of partnerships, if
  - (a) 50% or more of the capital of the partnership is owned by foreign nationals, or
  - (b) the majority of the partners are foreign nationals, and
- (iii) in the case of companies incorporated in Pakistan, if
  - (a) 50% of the shares or more are subscribed by foreign nationals, or
  - (b) 50% of the Directors on the Board of Directors or more, are foreign nationals. In the case of equal share-holding, a company is deemed to be a Pakistani controlled company, if its Chief Executive is a Pakistan National.

##### **3. General permission for lending to Foreign Controlled Companies for working capital.**

Authorized Dealers are authorized to grant rupee loans and credits to foreign controlled companies for meeting their working capital requirements subject to observance of Prudential Regulations prescribed under the Banking Companies Ordinance.

#### **4. Local Borrowings for Capital Expenditure.**

Foreign Controlled Companies are normally required to meet their requirements of capital expenditure out of their Rupee resources or from loans raised abroad with the permission of the Federal Government/State Bank. In special circumstances such companies are allowed to raise Rupee resources through medium and long term local borrowings. As an exception, foreign controlled companies engaged in manufacturing are permitted to meet their requirements of capital expenditure by taking loans from banks, Development Financial Institutions and other financial institutions or by issuing Participation Term Certificates etc.

#### **5. Borrowings by Individual Foreign Nationals.<sup>1</sup>**

Authorized Dealers have general permission to grant Rupee loans/overdrafts to Foreign Nationals up to the extent of their requirement subject to the observance of relevant Prudential Regulations.

#### **6. Loans and Overdrafts to Non-Residents including Loans for Purchase of Residential Plots/Houses/Flats by Overseas Pakistanis.**

(i) Authorized Dealers may grant purely short term Rupee loans or overdrafts to their overseas branches and correspondents, in the normal course of their business, without reference to the State Bank, provided such loans or overdrafts are created as a result of negotiations under Rupee Letters of Credit, established by the overseas banks to finance exports from Pakistan, and are liquidated within a period not exceeding two weeks.

(ii) Authorized Dealers may grant Rupee loans to those Pakistan Nationals resident outside Pakistan, who are maintaining Foreign Currency Accounts with them, against the security of the balances held in such accounts.

(iii) Authorized Dealers/Development Financial Institutions/Housing Finance Institutions may grant rupee loans to those Pakistan nationals who are working outside Pakistan, for purchase of residential flats/plots/houses in Pakistan up to 90% of the cost/price of the flat/plot/house subject to the condition that the loan will be liquidated by the borrowers through remittances from abroad in foreign exchange through normal banking channel or by debit to their Foreign Currency Accounts. The initial down payment of the purchase price of the flat/plot/house up to 10% of the total price can be financed by the purchaser/borrower from his savings in Pak rupees.

The above permission is, however, subject to the following terms and conditions:-

- a. The rupee loan shall be extended to those non-resident Pakistanis only who are working abroad and do not own immovable property outside Pakistan, for the purpose of purchasing a residential plot or house/flat and not for any commercial purposes.

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<sup>1</sup> F.E. Circular No. 13 Dated June 25, 2003.

- b. Loans will be extended by the banks/DFIs/Housing Finance Institutions subject to observation of the normal rules and Prudential Regulations.
- c. Sale proceeds of the residential plot/flat/house on disinvestment shall not be eligible for repatriation in foreign exchange or for credit to a Foreign Currency Account/Convertible Rupee Account of the purchaser/owner.

**7. Loans and Overdrafts against Guarantees of Non-Residents or against Collateral held outside Pakistan.**

Authorized Dealers are given general permission under the Foreign Exchange Regulation Act, 1947 to grant rupee loans to their clients (including foreign controlled companies) against guarantees of non-residents/guarantees received from banks functioning abroad, subject to compliance with the credit restrictions imposed by the State Bank of Pakistan.

**Part B- Foreign Private Loans**

**8. Private Foreign Currency Loans.**

In terms of section 4(1) of the Foreign Exchange Regulation Act, borrowing from abroad without the previous general or special permission of the State Bank is prohibited. The State Bank has given general permission to Private Sector entrepreneurs to obtain foreign currency loans from banks/financial institutions abroad, parent companies of the multinationals and as suppliers credit including credits under PAYE Scheme, not involving government guarantee, for financing foreign currency cost of the projects covered by the government's Industrial/Investment Policy and the instructions issued by SBP from time to time. The loans should be contracted on the best possible terms. The repayment period of such loans/credits, however, should not be less than five years.

<sup>2</sup>However, pre-payment of Foreign Private Loans (other than the Government guaranteed loans), is permissible on a case-to-case basis.

The above facility can be availed by borrowers who have the Rupee counterpart available with them or they have the capacity to generate Rupee funds at their own and that the loans are otherwise remittable i.e. the remittance formalities have been completed.

All applications in this regard should be forwarded to Director, Exchange Policy Department, State Bank of Pakistan, I.I. Chundrigar Road, Karachi with full details for consideration and necessary approval.

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<sup>2</sup> F.E. Circular No. 21 Dated December 21, 2002.

## **9. Pay-As-You-Earn (PAYE) Scheme.**

Since February, 1973 the Government has instituted a scheme of Suppliers Credit called PAY-AS-YOU-EARN (PAYE) Scheme under which entrepreneurs in the private sector can negotiate foreign currency loans for import of plant and equipment for export oriented industries either for establishment of new industrial units or for balancing, modernization, replacement and expansion of the existing export oriented units. The industries covered by the Scheme are:

- (i) Export oriented industries which include:
  - (a) Industries such as fish processing and modern rice milling, the bulk of whose production is exported, and
  - (b) Industrial units set up for export market within industrial sub-sectors which serve both the local market and the export market, such as textiles, carpets, leather, fruits and vegetables. Units, to qualify under this category, must give a guarantee to export 50% or more of their total output. In special cases such as engineering goods, the limit may be reduced to 25% in the first three years and 33% thereafter.
- (ii) Sub-contracting arrangements for exports under which manufacturing units are established in response to specific orders, which are received from the foreign non-resident firms by local manufacturers as a sub-contractor, and
- (iii) Service industry like hotels etc.

## **10. Features of the Scheme.**

The main features of the PAYE Scheme, 1973 are as under:

- (a) Advance payment upto 15% of the C & F value of the machinery may be allowed provided the sponsors give an undertaking that in case machinery is not imported by the stipulated date, they will repatriate the foreign exchange to Pakistan or pay to the Government penalty amounting to 27% of the advance payment or any portion thereof which remains unrepatriated plus interest on it at the rate of 9% from the date of the remittance.
- (b) Projects established under the PAYE Scheme will be allowed a maximum of 50% of the F.O.B. value of their foreign exchange earnings in respect of goods manufactured and exported by the concerned units established or expanded under the Scheme for meeting their debt liability and other foreign exchange payments on account of royalty, technical fee and incidental charges.
- (c) If in any financial year, the debt servicing liability cannot be met out of the prescribed percentage of earnings in that year, the sponsors will have to pay to the Government penalty to the extent of 27% of the Rupee equivalent of the short-fall.

(d) If a project has been established against a loan in convertible currency, it will be required to meet its obligations in convertible currency. Where a project has been set up on the basis of a loan repayable in commodities, export of commodities to the lending country will count towards repayment of the loan. Export against convertible currency made by the units concerned from the new capacity created under the Scheme to countries other than the lending country, will also count towards repayment of the loan.

#### **11. Procedure for import of machinery and registration of repayment schedule.**

(i) Foreign currency private loan agreements and suppliers credit agreements including credit agreements under PAYE Scheme as permitted under para 8 ibid will be submitted to the State Bank for registration through the Authorized Dealer designated for the purpose within 30 days of the date of Agreement.

(ii) The Authorized Dealer will furnish the original loan/credit agreement alongwith five copies, a list of the company's Directors, project report showing the details of the project including its cost (broken into local cost and foreign exchange cost), location of the project and copy of Certificate of Incorporation of the company to the Investment Division, Exchange Policy Department, State Bank of Pakistan, Karachi. In the case of Buyer's Credit, three copies of the purchase contract will also be furnished.

(iii) Approval of the Government of Pakistan will also be furnished where the loan/credit is provided at concessional rates by the banks/financial institutions under the instructions or policy of the foreign Governments.

(iv) A copy of the loan/credit Agreement registered by the State Bank will be returned to the Authorized Dealer.

(v) The loan amount from foreign banks/financial institutions can be deposited in a foreign currency account to be opened under the general permission given vide paragraph 9 of Chapter 6.

(vi) After registration of the agreement with the State Bank, remittance of down payment may be made by the Authorized Dealers to the extent provided in the agreement. Such remittances shall be reported to the concerned area office of Foreign Exchange Operations Department, SBP-Banking Services Corporation, on Form 'T' which, for statistical purpose is to be coded by them with appropriate commodity code on Schedule E-2 with Department code as 750.

(vii) Alternatively, the sponsors may arrange a loan for financing down-payment to the suppliers of plant and machinery. Such a loan will be subject to registration in accordance with the above procedure.

(viii) In order to establish the value of plant and machinery imported under the loan/Supplier's Credit, including credits obtained under PAYE Scheme, the sponsors will, immediately on

receipt of the consignment, submit to the area office of Foreign Exchange Operations Department through the designated Authorized Dealer, the relative import documents viz. Exchange Control copy of Bill of Entry, original invoice and a copy of letter of credit.

(ix) After the liability to the foreign lender/supplier of plant and machinery as mentioned in sub-paragraph (viii) has been established, the repayment schedule as per specimen given at Appendix V- 87 should be submitted for registration to the Investment Division, Exchange Policy Department, SBP, Karachi in sextuplicate through the Authorized Dealer which has submitted the loan agreement.

## **12. Repayment under Pay-As-You-Earn Scheme.**

(i) After the repayment schedule has been registered by the State Bank, the remittances on account of principal and interest will be allowed by the Authorized Dealer subject to compliance with the requirements set out herein and after deduction of tax if payable. In case of exemption from income tax, a copy of the exemption certificate should be attached with the relative 'M' form. The application for remittance towards repayment of cost of plant and machinery and interest accrued thereon (instalment) will be submitted on the prescribed form (Appendix V- 88) to the Authorized Dealer whose name appears on the related repayment schedule. The application should be signed by the applicant and certified by the bankers and must be accompanied by Export Realization Certificate in the prescribed form (Appendix V- 89). The application will be accompanied by two forms 'M' i.e. one for the amount of principal and the other for the amount of interest. Remittances on account of repayment of principal and payment of interest should be coded by the Authorized Dealers as 1830 and 1220 respectively, on Schedule E-4 with Departmental Code as 775 in each case. Where the amount of 50% of the FOB value of export earnings of an industrial unit or enterprise in any financial year, upto the date on which the instalment has fallen due, is not sufficient to cover the debt liability and other liabilities as laid down in Clause 7 of the Scheme, the remittance may be allowed by the Authorized Dealer concerned on submission of an undertaking by the applicant to the effect that he will submit evidence of having repatriated sufficient export earnings during the financial year concerned, to cover the remittance and that in case there is any shortfall, a penalty amounting to 27% of Rupee equivalent of the excess remittance plus interest thereon @ 9% per annum from the date of remittance, shall be paid to the State Bank on account of the Federal Government by the 8th July of the next financial year. This undertaking should be countersigned by the Authorized Dealer concerned, who should assume responsibility for the payment of the penalty and interest and forward the undertaking to the State Bank alongwith the form 'M' covering the remittance.

(ii) In respect of remittances made under the PAYE Scheme, the Authorized Dealers will send to the SBP-Banking Services Corporation every month statements in triplicate in the prescribed forms (Appendices V- 90 & V- 91).

(iii) In case any discrepancy is found in the information contained in an application (Appendix V- 88 ) or export realization certificate (Appendix V- 89) on the basis of which an Authorized Dealer has allowed remittance of principal and interest, the applicant will be



required to arrange for repatriation to Pakistan of the amount, if any, remitted in excess or alternatively on demand by the State Bank, pay to it on account of the Federal Government penalty amounting to 27% of Rupee equivalent of the excess remittance plus interest thereon @ 9% per annum from the date of remittance. The Authorized Dealer who has allowed the remittance shall be responsible for compliance with the above requirements including payment of penalty and interest.

### **13. Payment of Penalty-Head of Account.**

The penalty of 27% recoverable from the applicants under the above Scheme should be deposited with the SBP-Banking Services Corporation by the concerned project or its bankers on challans filled in quadruplicate for credit to Federal Government's account with the State Bank under the head "1000 Non-Tax Receipts 1300 Miscellaneous Receipts-1390 others-Fees, Fines and Forfeitures".

### **14. Repayments under loans/credits other than PAYE Loans.**

(i) After the repayment schedule has been registered by the State Bank, the remittance on account of principal, interest and other charges will be allowed by the Authorized Dealers strictly in accordance with the approved schedule. Remittance of interest will be effected after deduction of tax, if payable. In case of exemption from income tax, a copy of the exemption certificate should be attached with the relative 'M' form. Remittances on account of repayment of principal and interest shall be reported separately on forms 'M' and coded as 1952 and 1212 respectively with Department code 121. Such 'M' forms should be prominently marked at the top as under:

"Remittance of Principal/Interest under Loan/Supplier's Credit vide Repayment  
Schedule Registered with the State Bank under Registration No  
....."

(ii) In some cases of Loans/Supplier's Credits, interest is payable at a varying rate linked with LIBOR. In such cases, it would not be possible for the borrowers to show in advance the exact amount of interest payable with future instalments. It would be in order for the Authorized Dealers in such cases to remit the actual amount of interest calculated on the basis of the formula appearing in the approved contract. They should, however, show the number of days, the applicable rate and the principal amount on which interest has been paid in the 'M' form.

### **15. Repatriable Foreign Currency Loans by Foreign Controlled Companies.**

(i) Foreign controlled companies are permitted to contract foreign currency loans from banks/financial institutions abroad or from their Head Offices/or from other overseas branches/associates for meeting their working capital requirements. The repayment period should not exceed twelve months and the rate of interest should not exceed 1% over LIBOR. Such loans can however be rolled over for further periods not exceeding twelve months each.

(ii) Foreign controlled companies, as defined in paragraph 2 *ibid*, desirous of availing this facility may approach their bankers (Authorized Dealers), who will satisfy themselves that the applicant is a foreign controlled company. Once such a confirmation is obtained, the concerned company may contract the loan and repatriate the amount for credit to their Rupee account with the Authorized Dealer.

(iii) The concerned Authorized Dealer will issue a proceeds realization certificate, and record the particulars of the loan. On maturity, the Authorized Dealer having received the inward remittance will allow payment of interest minus taxes and repayment of principal. While reporting remittance of interest, a certificate confirming the applicable LIBOR and a certificate confirming payment of income tax will be attached with the Form 'M'. If tax is not payable, a copy of the exemption certificate issued by the Revenue authorities will be submitted. While reporting repayment of the principal, a copy of the proceeds realization certificate will be attached with the Form 'M'.

(iv) Branches in Pakistan of foreign companies are not allowed to pay interest on such loans.

(v) Foreign contractors are not allowed to pay interest on such loans, and they can repay the loans only after they have completed the contracted work/project and have submitted clearance certificate from the tax authorities, which should be attached with the Form 'M'.

#### **16. Foreign Currency Loans for Financing Exports.**

(i) Those exporters who have valid firm commitments with the overseas buyers for export of goods from Pakistan may obtain short term loans in foreign currencies from abroad or through an Authorized Dealer, to the extent of the value of such firm commitment, to enable them to finance the export of goods from Pakistan. It is permissible to obtain one consolidated loan for all LCs/contracts received in a month or covering shipment required to be made during a month. The Authorized Dealers may issue guarantees to the lenders subject to compliance with Prudential Regulations in force.

(ii) The Authorized Dealers and borrowers will be free to negotiate the interest rates on such loans. The maximum tenure of such loans will be the period generally fixed for repatriation of export proceeds plus a further period of sixty days. The exchange risk will be borne by the borrower.

(iii) The foreign currency amount of loan will be required to be repatriated to Pakistan and encashed with an Authorized Dealer. Such inward remittances will be reported on form 'R' Schedule 'J' with Code No. 9711.

(iv) In case an exporter utilizes this facility, he will not be eligible to obtain export finance in local currency from a bank in Pakistan and the facility under the 'Foreign Currency Export Finance Scheme' for the same export commitment.

(v) The foreign currency loan will be required to be repaid, along with interest, out of the related export proceeds. Where an exporter is unable to export goods against a firm contract/letter of credit against which a foreign currency loan was obtained, he may repay the loan from the proceeds of export of the same or other commodity to the same or a different buyer in any country against another firm contract/letter of credit provided no foreign currency loan has been obtained against the substituted contract/letter of credit. The exporter will instruct the Authorized Dealer, through which the loan was received, and which is negotiating/handling the export documents, to arrange to repay the foreign currency loan and interest accrued thereon, less tax if payable, to the lending institution out of the proceeds of the bill. It is not necessary to repatriate the proceeds of the export bills to Pakistan first and then to arrange remittance in repayment of the debt. The amounts of the export bills realized abroad can straight-away be used for repayment of the amount of the relative debt and net interest. The concerned Authorized Dealer will however, report the realization of foreign exchange proceeds of the exports as a 'purchase' on Schedule A-1 and the amount of loan and interest paid as 'sale'. At the time of reporting sale, the Authorized Dealer will attach with the relative form 'M':

(a) Proceeds Realization Certificate.

(b) Income Tax Officer's/Auditor's certificate indicating the amount of tax due on the interest accrued on the foreign currency loan.

It will be the responsibility of the Authorized Dealer to ensure while arranging payment/remittance of interest that the payment is made after deduction of tax leviable thereon.

(vi) In case the loan matures after the export proceeds have been realized, the export proceeds to the extent required for repayment of the loan and net interest on the due date, may be retained in a foreign currency account temporarily opened for this purpose, repayment made on the due date and the account closed.

(vii) Notwithstanding the utilization of export proceeds for repayment of the loan, the Authorized Dealers will continue to be liable to deduct income tax as required by the Tax laws.

(viii) In case the exporter fails to fulfill the export obligations or there is a delay in realization of export proceeds, repayment of loan and interest accruing thereon less taxes, will be made by him from his own resources or from a foreign currency account.

(ix) In the case of exports to ACU member countries where export proceeds are not realized in convertible currencies, Authorized Dealers may remit the amounts of principal/interest from their Nostro balances at the current exchange rate subject to compliance of the drill laid down in preceding sub-para (v).

## **17. Foreign Currency Loans for Working Capital and other purposes.**

(i) Pakistani firms and companies functioning in Pakistan excluding banks may obtain foreign private loans on non-repatriable or repatriable basis for their working capital subject to the following terms and conditions:

**(A) NON-REPATRIABLE BASIS:**

The loans are contracted on non-repatriable basis on the clear understanding that such loans would be treated as rupee loans to the extent of rupees generated out of the inward remittance, neither the principal nor interest/profit would be remittable abroad at any time and repayment of the loan and payment of interest/profit would be made in Pakistan.

**(B) REPATRIABLE BASIS:**

- (a) The loan is interest free and for a period not less than one year.
- (b) No bank guarantee for securing such loans would be provided from Pakistan.
- (c) No forward cover shall be provided.
- (d) The Government of Pakistan will not provide the facility of absorption of exchange risk in such cases.

Agreement for foreign private loans on repatriable basis should be submitted to the State Bank for registration. After the State Bank has registered the agreement and the loan amount has been remitted to Pakistan, the repayment schedule (Appendix V- 87) should be submitted to the State Bank for registration alongwith proceeds realization certificate. After the repayment schedule has been registered, the Authorized Dealers would be free to remit the instalments of principal on the due dates quoting reference of the repayment schedule, in accordance with the procedure laid down in paragraph 14 *ibid*. No pre-payments would be permissible.

(ii) Individuals/firms/companies resident in Pakistan, including foreign controlled companies and branches of foreign companies operating in Pakistan, but excluding banks are also permitted to obtain loans from abroad in foreign currencies on repatriable basis for any purpose on the following terms and conditions: -

- (a) There shall be no ceiling on the amount of loan. The repayment period should not, however, be less than five years, and the repayments should be made in equal instalments.
- (b) Interest will be payable in arrears on half yearly/yearly basis at a rate not exceeding the relevant LIBOR + 1.5% and will be subject to deduction of Pakistan taxes as may be leviable under the law. The borrowers shall be free to pay interest according to the above formula at a fixed or floating rate.

- (c) Exchange rate fluctuation risk will be borne by the borrowers and no forward cover would be provided by the Authorized Dealers in Pakistan.
- (d) No bank guarantee for securing such loans would be provided from Pakistan.
- (e) The borrower will get the agreement with foreign lenders registered with an Authorized Dealer who will handle all transactions thereunder and intimate the details after completion of the disbursements, to the Investment Division, Exchange Policy Department, SBP, Karachi in the prescribed proforma (Appendix V- 92) in triplicate alongwith Proceeds Realization Certificate(s) in original showing encashment of the loan amount into Pak Rupees. Thereafter the Authorized Dealer would be free to remit the instalment(s) of principal and interest, as the case may be, on due dates strictly in accordance with the terms of repayment intimated to the State Bank. Prepayments would not be permissible. Remittance of interest will be effected after deduction of tax, if leviable thereon.
- (f) (A) The inward remittances on account of loan disbursement from foreign lenders may be reported under Code-9821.
- (B) Likewise the outward remittance on account of repayment of principal shall be reported on Form 'M' and Coded as 1821.
- (C) Remittance of interest will be reported under Code- 1224.

#### **18. Short term Borrowings in Foreign Currency by Authorized Dealers.**

Authorized Dealers may, if it becomes necessary in the normal course of their business but not for the purpose of carrying speculative exchange position etc., obtain short-term loans and overdrafts from overseas branches and correspondents for periods not exceeding seven days at a time. If such loans or overdrafts are required to be secured by collateral to be lodged in Pakistan or else where, full details of the proposed arrangements should be furnished to the State Bank for prior approval.

Interest on short-term loans and overdrafts taken under this para may be remitted by Authorized Dealers without the prior approval of the State Bank.

#### **19. Long Term Borrowings in Foreign Currency by Authorized Dealers.<sup>3</sup>**

(i) It is not permissible for Authorized Dealers to obtain long-term loans in foreign currencies without the prior approval of the State Bank. Application for this purpose should be made to the State Bank, giving the terms of the proposed loan and the reasons why it is considered necessary to contract such a loan.

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<sup>3</sup> F.E. Circular No. 03 Dated June 15, 2007.

(ii) As an exception to the above, Authorized Dealers are allowed to raise foreign currency (FCY) borrowing from International Financial Institutions for converting into PKR and using the same (PKR) for liquidity management. While borrowing such FCY funds, Authorized Dealers are required to ensure the following:

- a) Authorized Dealers (ADs) are allowed to borrow foreign currency to a maximum of 50% of their unimpaired Capital as per their last Audited Financial Accounts.
- b) The borrowing is permitted in currencies namely USD, EUR, GBP and JPY.
- c) The minimum tenor of the FCY borrowing should not be less than 1 year. The borrowing bank (ADs) will be allowed to make repayment of the principal amount in bullet at maturity or may start repayment of principal in installment after one year. However, frequency of the interest payment may be made in accordance with the related repayment schedule.
- d) Interest may be payable at a rate not exceeding the relevant LIBOR + 1.50%. Any exception to the above rate should be referred to Exchange Policy Department, SBP for prior approval.
- e) ADs will not be allowed to offer any security/collateral/guarantee whatsoever to the lenders as the borrowing will be clean and based on balance sheet strength of the borrowing bank (AD).
- f) Borrowing bank (AD) will not be allowed to sell such FCY funds out-rightly in the interbank market or to the customers. Similarly, such FCY funds cannot be used by borrowing bank for extending any FCY trade loan facility.
- g) Borrowing bank (AD) will be allowed to enter into FCY/PKR sell/buy Swaps in the interbank market. Though, the tenor of these Swaps may range from 1- month to 1-year, however, at any point in time, the outstanding amount of related Net Forward Purchases should not be lower than the FCY amount borrowed under this arrangement.
- h) ADs are advised to monthly report FCY transactions on the prescribed format (Appendix V-93) to Banking Surveillance Department and Exchange Policy Department by 10th day of the following month.

(iii) The above permission is being granted to the ADs for their liquidity management. However, ADs are expected to exercise utmost prudence while entering into such arrangements.

## **20. Loans and Advances by Authorized Dealers in Foreign Currency.**

Authorized Dealers will not grant any loans or overdrafts in foreign currencies, whether secured or unsecured, without the prior approval of the State Bank. Applications for this purpose should be made by letter, giving full details of the purpose for which such loans or overdrafts are required as also the particulars of the guarantee or collateral, if any, and the manner in which the loans or overdrafts are expected to be liquidated.

## **21. Special FCY Borrowing by Micro Finance Banks/Institutions (MFB/Is)<sup>4</sup>**

Micro Finance Banks/Institutions are allowed to raise foreign currency (FCY) loans from International Financial Institutions/Donor Agencies or Specialized banks/Institutions. For this purpose, MFB/Is (not being Authorized Dealers) may apply to the Director, Exchange Policy Department, State Bank of Pakistan for obtaining approval in-principle. While negotiating such borrowing, MFB/Is are required to ensure the following terms and conditions:

- i) The purpose of loan must only be to finance the loan portfolio of MFB/Is.
- ii) Borrowing may be raised in major four currencies namely USD, EUR, GBP and JPY.
- iii) Minimum tenor of the FCY borrowing should not be less than 2 years.
- iv) The loan pricing will be based on a reference rate such as LIBOR. Interest rate may be decided on best possible terms, and must be competitive to other options available locally.
- v) The disbursed FCY funds will immediately be converted into PKR and credited to borrowing MFB/Is' PKR account maintained with the concerned Authorized Dealer (bank). Under no circumstances MFB/Is will be allowed to retain such funds in foreign currency.
- vi) The borrowing MFB/Is will be allowed to make payment of the principal amount in bullet at maturity or may start repayment of principal in installments after six months through the Authorized Dealer receiving disbursement of loan. However, frequency of the interest payment may be made in accordance with the related repayment schedule.
- vii) Authorized Dealers may provide forward cover/hedging facility on the foreign currency loans to the MFB/Is from the inter-bank market in accordance with the prevailing foreign exchange regulations.
- viii) The MFB/Is will provide an undertaking that the loan deal is compliant with the provision of legal and regulatory framework applicable to the lender and the borrower.
- ix) Draft Term Sheet agreed between the lender and borrowing MFB/Is should be submitted to SBP while approaching for in-principle approval. However, for formal approval, MFB/Is will approach SBP through Authorized Dealer (bank).
- x) MFB/Is will ensure that internationally acceptable 'Know Your Customer' (KYC) standards for the lending institutions/lenders are complied. Funding should only be obtained from quality lenders which comply with KYC standards.

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<sup>4</sup> F.E. Circular No. 08/2009 Dated November 25, 2009.

- xi) Any change/deviation in the terms and conditions after obtaining formal approval from SBP will require prior clearance from SBP.

### **Part C- Guarantees etc.**

#### **22. Guarantees on behalf of Foreign Controlled companies.**

For the purposes of Section 18(2) of the Act, guarantees that are issued in lieu of earnest money, security or other cash deposits are treated as extension of credit to the extent these are not backed by 100% cash deposit. Authorized Dealers may issue such guarantees on behalf of foreign controlled companies only by adjustment of the amount from their borrowing entitlement as per Prudential Regulations. This, however, would not be necessary where guarantee required to be issued are not in lieu of cash deposit but are either in the nature of performance bond etc., or are required to be given alongwith the tender documents in lieu of earnest money deposit. In the latter case, the validity of the guarantee would be restricted to the period upto which decision about acceptance or rejection of the relative tender is taken. The State Bank's prior approval will become necessary if the guarantee is to remain valid even after the decision on the tender has been taken.

#### **23. Guarantees on behalf of Residents of Pakistan in favour of Non-residents.**

(i) Except in cases covered by paragraphs 25 and 27 *ibid*, prior approval of the State Bank is required for giving any guarantee or undertaking or opening of a letter of credit, the implementation of which may involve payment to a non-resident either in foreign currency or Rupees. Applications seeking permission for giving such guarantee or undertaking should be made by letter giving full particulars of the guarantee or under-taking viz., the amount, the period and the purpose of the guarantee and the terms of payment in the event of the guarantee being implemented. These restrictions also apply to renewal of such guarantees, undertakings, letters of credit etc. While forwarding applications for renewal to the State Bank, Authorized Dealers should state the extent upto which the facilities covered by the guarantees were utilized during the previous twelve months or during the validity of the guarantees etc., if the period involved is less than 12 months.

(ii) Authorized Dealers may, however, issue guarantees in favour of foreign suppliers/lenders to cover repayment of loan and payment of interest under Foreign Private Loan/Suppliers Credit including credits under PAYE Scheme in accordance with the terms and conditions of the agreement as registered by State Bank, under intimation to Investment Division, Exchange Policy Department, SBP, Karachi.

#### **24. Guarantees on behalf of Non-Residents in favour of Residents of Pakistan.**

Prior approval of the State Bank is required for giving guarantees or undertakings in favour of residents in Pakistan either on behalf of non-residents or against overseas guarantees or collaterals lodged outside Pakistan. This restriction does not, however, apply to cases covered under paras 28 and 29 or where the guarantee is being extended by the Authorized Dealer on the



basis of a back-to-back guarantee from its overseas branch or correspondent. Applications for this purpose should be made by letter giving full particulars including the amount, the period and the purpose of the guarantee and the manner in which the Authorized Dealer will be reimbursed in the event of the guarantee being implemented. Renewal of such guarantees also requires the prior permission of the State Bank. While forwarding applications, Authorized Dealers should state the extent to which the facilities covered by the guarantee or undertaking etc., have been utilized during the previous 12 months or such shorter period for which the facilities have been available.

## **25. Performance/Bid Bond Guarantees.**

Authorized Dealers, National Insurance Company Limited, Pakistan Insurance Corporation and those Insurance Companies whose exposure limits have been fixed by the Controller of Insurance for the above purpose (particulars of Insurance Companies could be obtained from the Controller of Insurance) may issue Performance or Bid Bond Guarantees on behalf of exporters, members of recognized Consultancy/Construction Associations and Companies approved by Pakistan Engineering Council (PEC) in Pakistan subject to the following conditions:

- a. Tenders specifically call for furnishing of such guarantees.
- b. The beneficiary abroad is a foreign Government or a Government sponsored Organization or private company or a firm.
- c. The tenderer is a bonafide exporter or a manufacturer of the commodity which is specified in the tender and there is no restriction on its export from Pakistan.
- d. In case of Consultancy/Construction firms and Engineering firms recognized by Pakistan Engineering Council, the organization issuing the performance or bid bond must satisfy itself that the tenderer is a bonafide Consultancy/Engineering firm, having the requisite financial and technical resources and there are reasonable prospects of their being able to successfully execute the contract. Companies with poor track record will not be eligible.

## **26. Remittances under Guarantees or Performance Bonds and their Reporting to the State Bank.**

Authorized Dealers may make remittances against the Performance Guarantees or bonds issued by them or the Pakistan Insurance Corporation or National Insurance Company Limited or those Insurance Companies whose exposure limits have been fixed by the Controller of Insurance in terms of Para 25 *ibid*, if remittances become necessary for the implementation of such Performance Guarantees or bonds. In these cases, Authorized Dealers should minutely scrutinize the terms of the Performance Guarantees or bonds and satisfy themselves that the amount has become payable to the beneficiaries due to the default of the party in Pakistan. While reporting remittances made against such Performance Guarantees/Bonds to the Foreign Exchange Operations Department in their monthly foreign exchange returns, the Authorized

Dealers will bunch Forms 'M' with the documents given below alongwith the covering statement in duplicate as per Form (Appendix V- 94):

- i) Photocopy of the Guarantee or Performance Bond.
- ii) Photocopy of the claim received by the foreign bank from the concerned Government or the Government institutions or a private company or a firm demanding such payment.
- iii) Copies of correspondence, if any, exchanged between the foreign bank and foreign government or Government Institution or a private company or a firm.
- iv) Copies of correspondence exchanged by the firm in Pakistan on whose behalf Guarantee/Bond was issued with the concerned foreign Government or Government Institution or a private company or a firm about invoking of the Guarantee/Bond by the latter.

**27. Opening of Letters of Credit and Advising of Negotiations under Export Letters of Credit.**

Restrictions imposed under para 23 of this chapter shall not apply to the establishment of letters of credit or similar undertakings by the Authorized Dealers to finance imports into Pakistan in accordance with the provisions of Chapter-13. Similarly restrictions imposed under para 24 shall not apply to advising of export letters of credit established by non-resident banks nor to negotiation of documents thereunder.

**28. Guarantees which may be given without Prior Approval.**

The restrictions in paragraphs 23 and 24 do not apply to guarantees given by Authorized Dealers in favour of non-residents on behalf of their customers in the ordinary course of their business in respect of missing documents, authentication of signatures, release of goods on Trust Receipts and defects in documents negotiated by them under letters of credit etc.

**29. Guarantees and Collaterals in favour of Overseas Bank Branches and Correspondents.**

Authorized Dealers should not, without the prior approval of the State Bank, furnish guarantees to the overseas bank branches or correspondents or hold collaterals on their behalf in respect of any credit facilities or guarantees the latter may give or for any other purpose. All applications for this purpose should be made to the State Bank by letter giving full details of the guarantees or collaterals, as the case may be, and of the transaction in cover of which guarantee is proposed to be given or collaterals deposited.

**30. Renewal of Loans and overdrafts.**

In cases where the grant of any loans or overdrafts or issue of guarantees requires the prior approval of the State Bank, the renewal of such loans, overdrafts or guarantees shall also require the prior approval of the State Bank.