State Bank of Pakistan

Prudential Regulations for Small & Medium Enterprise Financing

Infrastructure, Housing & SME Finance Department

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Preface

SMEs represent 30 percent of national GDP, 25 percent of exports of manufactured goods, and 35 percent of manufacturing value added. Thus, the impact of financial exclusion on this sector has important implications for economic growth, competitiveness, and job creation. The potential for this sector to contribute to the economic development objectives of Pakistan, including generating employment, increasing incomes, and reducing poverty is the justification for a strategy of support to unleash the sector's potential. Keeping this in view, SBP issued separate Prudential Regulations for SMEs in 2003.

Overtime, the banks/DFIs' exposure to SMEs, however, have shown tilt towards large-size corporate and medium enterprises, thus neglecting the *Small Enterprises* in their banking business. This has necessitated a review of the existing SME Prudential Regulations to give boost to the efforts being made for improving SEs' access to finance. Accordingly, *Small* and *Medium Enterprises* are being separately defined, along with formulation of some specific regulations for the Small Enterprises (SEs). We feel that a separate definition for *Small Enterprises* will not only help banks/DFIs to align their business strategy with the SE Financing needs, but will also help SBP to monitor the flow of credit to this important sector more closely.

Since Medium Enterprises relatively are less credit constrained in accessing loans on account of their size and sophistication level, the Regulations governing them have not been changed, with the exception of separate definition for Medium Enterprises, and revising their individual & aggregate exposure limits upward.
It is worth-mentioning that providing enabling Regulatory Framework is one important aspect only. Visible improvement in SME Financing will only occur when the banks/DFIs re-position themselves strategically in the market by appropriately aligning their business strategies with the specific needs of the SME sector. The Regulatory Framework will bear its intended results, only if the banks/DFIs take the necessary steps including the following:

- Bring Strategic change at higher level to expand share in SME portfolio.
- Use relevant/practical cash flow estimation techniques and other proxies to assess repayment capacity of SME borrowers.
- Adopt Program-based lending & down scaling strategies.
- Allocate adequate resources for Research & development.
- Make appropriate alignment in their Risk Management processes.
- Take effective measures to capture market niche by conducting market segmentation
- Strengthen credit appraisal and monitoring mechanism by greater use of Technology and Documentation to undertake effective review of SME Portfolio.
- Effective use of internal audit and control functions.
- Adopt measures for greater '*financial awareness'* of SMEs specially "SEs"

It may be noted that revised PRs are applicable with immediate effect for the fresh financing facilities. However, since the banks/DFIs need to segregate their existing SME portfolio according to the new definitions and revised classification criteria, Banks/DFIs are allowed a maximum implementation period up to September 30, 2013 for the purpose for existing portfolio.

State Bank of Pakistan will be monitoring the situation closely, and will work with banks / DFIs to make SME Banking a viable success on sustainable basis. For this purpose, SBP will be open to review any regulatory provision, if necessary, while ensuring at the same time that banks/DFIs observe due prudence and necessary oversight.

The Prudential Regulations for Small and medium Enterprises (SMEs) Financing covers Risk Management (R) aspects. The Prudential Regulations for Corporate/Commercial banking may be referred to for areas concerning Corporate Governance (G), Customer Due Diligence and Anti Money Laundering (M), and Operations (O) aspects, However, in case of international operations, the Prudential Regulations of host country shall prevail.

The Prudential Regulations for Small and medium Enterprises (SMEs) do not supersede other directives issued by State Bank of Pakistan in respect of areas not covered here. Any violation or circumvention of these regulations shall render the bank/DFI/officer(s) concerned liable for penalties under the Banking Companies Ordinance, 1962.

Syed Samar Hasnain
Director
IH & SME Finance Department

Dated: May 7, 2013

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Chapter No: 01 Prudential Regulations - General for Small & Medium Enterprise Financing

Regulation SME-1: SME Specific Credit Policy

Banks/DFIs shall prepare a comprehensive SME Specific Credit Policy duly approved by their Board of Directors. The Credit Policy shall give special mention to the Small Enterprises Financing keeping in view their specific characteristics and business conditions. The Credit Policy shall, interalia, cover the following for SME financing:

i. Clearly laid down procedures on Loan administration, disbursement, monitoring, and recovery mechanism.
ii. Specification of main functions, major responsibilities of various staff positions, as well as their powers/authority relating to approval/sanction of financing limits.

Additionally, for the SE Financing, the Credit Policy shall cover the following minimum points:

iii. Clearly devised plan regarding the frequency of visits to their SE borrowers' business site keeping in view their human resource limitations and the amount of exposure taken by them, subject to the condition that the banks/DFIs shall visit the borrower's site at least once in a year.
iv. In case the finance is secured against hypothecation of stock, the banks shall obtain stock report at least semi-annually.
v. For loan size up to Rs 1 million in case of Small Enterprise only, it will be at the discretion of the banks/DFIs to obtain Insurance Cover of hypothecated stock/other securities, keeping in view the creditworthiness of the borrower, his past experience and financial strength. Further, in case the banks require the borrower for insurance cover, then the borrower shall not be forced to arrange such cover only from an insurance company of the banker's choice.

It may, however, be noted that for program-based lending, the banks/DFIs' respective Product Programs (approved by BOD) for each segment/area shall suffice. Such Programs may carry objective/quantitative parameters for eligibility of borrower, beside standardization and simplification of loan documents required from the borrowers under the subject Program.

Regulation SME-2: Borrowers Basic Fact Sheet and e-CIB Report

(i) Banks/DFIs are required to obtain Borrower's Basic Fact Sheet (BBFS) from their prospective borrowers as per format given at Annexure-I and IV, at the time of sanctioning fresh facility, or enhancement, renewal and restructuring of an existing facility. However, if the Loan Application Form already contains all the information as required in BBFS, then no separate BBFS shall be required.

(ii) Banks/DFIs shall obtain e-CIB Report on the prospective borrower while considering proposals for any exposure (including renewal, enhancement and rescheduling/ restructuring). Banks/DFIs shall give due weightage to the credit report relating to the borrower and his group obtained from e-CIB of State Bank of Pakistan; however, they can take exposure on defaulters keeping in view their risk management policies and criteria provided they properly record reasons and justifications in the approval form.

Regulation SME-3: Personal Guarantee

All facilities, except those secured against liquid assets, shall be backed by personal guarantees of the owners of SMEs. In case of limited companies, guarantees of all directors other than nominee directors shall be obtained.

Regulation SME-4: Limit on Clean Facility

Banks/DFIs can take clean exposure (facilities secured solely against personal guarantees) on an SME borrower up to Rs 5 million. Before taking clean exposure, banks/DFIs shall obtain a declaration from the SME to ensure that the accumulated clean exposure on an SME does not exceed the prescribed limit mentioned above.

It may be noted that clean exposure limit shall not include the clean consumer financing limits (Credit Card and Personal Loans etc) allowed to sponsors of the said SME under Prudential Regulations for Consumer Financing.

Regulation SME-5: Proper Utilization of Loan

The banks/DFIs shall ensure that loan has been utilized for the same purposes as specified in the Loan Application Form. In case of financing to *Medium Enterprises*, banks/DFIs shall develop and implement an appropriate system for monitoring utilization of loans. Such system may include obtaining stock reports/position of current assets in case of Working Capital Loans; and supporting documents in case of Term Loans.

With regard to *Small Enterprise Financing*, banks/DFIs shall adopt the following measures:

i. In case of working capital/revolving credits, the banks/DFIs will obtain a declaration only from the borrowing SE stating that it has utilized the loan proceeds for the intended purpose only.

ii. In the case of Fixed Assets/project financing, the bank/DFI will adopt the same process as mentioned above in the case of Medium Enterprise Financing

Regulation SME-6: Restriction on Facilities to Related Parties

The banks/DFIs shall not take any exposure on an SME in which any of its director, major shareholder holding 5% or more of the share capital of the bank/DFI or its Chief Executive, or an Employee or any dependent family member of these persons is interested, except as specified in section 24 of the BCO, 1962. In this regard, it will, however, suffice if banks/DFIs obtain an undertaking from the *Small Enterprise* stating that there is no existence of any interest between the borrower and the above-mentioned related parties.

Regulation SME-7: Translation of Loan Documents into Urdu Language

To facilitate SMEs in better understanding important terms and conditions of loans, Banks/DFIs shall translate and make available Loan Application Form, BBFS and other related documents, except charge documents, in Urdu as well. Further, the banks/DFIs will also provide information on important terms with brief explanation of each term for convenience and better understanding of the borrower. The banks/DFIs will ensure compliance with this regulation by September 30, 2013.

Regulation SME-8: Securities and Margin Requirements

i. Subject to the relaxation for clean facilities up to Rs. 5 million for SEs and MEs, all facilities over and above this limit shall be appropriately secured as per satisfaction of the banks/DFIs.

ii. Banks/DFIs are free to determine the margin requirements on securities against facilities provided by them to their clients taking into account the risk profile of the borrower(s) in order to secure their interests. However, this relaxation shall not apply in case of items, imports of which are banned by the Government. Banks/DFIs are advised not to open import letter of credit for banned items in any case till such time the lifting of ban on any such item is notified by the State Bank of Pakistan.

iii. Banks/DFIs shall continue to observe margin restrictions on shares/TFCs as per existing instructions under Prudential Regulations for Corporate/Commercial Banking (R-6). Further, the cash margin requirement of 100% on Caustic Soda (PCT heading 2815.1200) for opening Import Letter of Credit as advised by the Federal Government and notified in terms of BPD Circular Letter No. 5 dated 4th May, 2002, shall also continue to remain applicable.

iv. State Bank of Pakistan shall continue to exercise its powers for fixation/reinstatement of margin requirements on financing facilities being provided by banks/DFIs for various purposes including Import Letter of Credit on a particular item(s), as and when required.

v. In addition to above, the restrictions prescribed under paragraph 1.A of Regulation R-6 of the Prudential Regulations for Corporate/Commercial Banking will also be applicable in case of financing to Small and Medium Enterprises.

Regulation SME-9: General Measures

1. Pricing policy of banks/DFIs that include mark-up rates (including the IRR on the loan products), processing & documentation fee, prepayment/late-payment penalties etc. shall be mentioned explicitly in the loan agreements, i.e. the banks shall strictly avoid imposing any hidden charges in addition to those explicitly stated in the loan agreement.
2. To minimize the occurrence of grievances to SMEs, the banks/DFIs shall make the Customers Complaints Resolution System more transparent, customer focused and simple for effectively handling their complaints.

3. Banks/DFIs shall put in place an efficient MIS for SME Finance to effectively cater to the needs of SME Financing portfolio. The system should be flexible enough to generate necessary information reports for the management, and shall generate at least the following periodical reports:
   i. Delinquency reports (for 30, 60, 90 180 & 365 days and above) on monthly basis.
   ii. Reports interrelating delinquencies with various type of customers and sectors etc to enable the management to take important policy decisions and make appropriate modifications in the lending programs
   iii. List of SMEs having any kind of banking relationship with the bank/DFI with information on their organizational structure (proprietorships, partnerships, limited company etc) and area of business activity such as traders, service providers and manufacturers etc.
4. For successful SME lending, especially program-based lending, the banks/DFIs will develop strategies that will elaborate measures on improving delivery channels (branchless banking, tele-marketing etc.), adoption of credit scoring technology, improved understanding of the target market through field work and research, and putting in place strong marketing and sales culture.
5. The banks/DFIs shall take measures for capacity building and training of SME banking staff in the areas of product development, program-based lending techniques and risk mitigation etc.
6. Besides financing products, banks/DFIs are encouraged to leverage on the data base of their SME depositors for possible sale of financing products to them, thus increasing their revenue base through clients that have already a banking history with them.

Chapter No: 02 Prudential Regulations for Small Enterprise Financing

Regulation SE-1: Definition of Small Enterprise

A Small Enterprise (SE) is a business entity which meets both the following parameters:

Number of Employees	Annual Sales Turnover
*Up to 20	Up to Rs. 75 million

*****_including contract employees_.

Regulation SE-2: Per Party Exposure Limit

Small Enterprise can avail exposure up to Rs 15 million from a single Bank/DFI or from all Banks/DFIs.

Regulation SE-3: Requirement of Audited Accounts

Banks/DFIs are not required to obtain copy of audited accounts in case of lending to the Small Enterprises. However, banks/DFIs may ask the borrower to submit financial accounts in some form, signed by the borrower, to help banks/DFIs assess SEs cash flows or carry out counter verification etc.

Regulation SE-4: Repayment Capacity of the Borrower and Cash Flow Based Lending

Normally, Small Enterprises do not maintain proper financial accounts for the satisfaction of the banks/DFIs. Their record generally contains sale/purchase books and cash received/paid records in a rudimentary form. Banks/DFIs shall use relevant/practical cash flow estimation techniques and other proxies to assess repayment capacity of SE borrower. To supplement, banks/DFIs are encouraged to use the available sector/cluster specific financial models that can capture cost structure, revenue streams and margins in the sectors. For program-based lending, banks/DFIs, as a substitute, may also use *Income Estimation Models* to assess repayment capacity of the borrowers.

Regulation SE-5: Collateral Valuation

For valuation of securities against loans up to Rs. 5 million, banks/DFIs at their own discretion may either use the services of their own evaluating staff or the services of PBA approved evaluator. However, valuation of securities for loans above Rs. 5 million shall be done only by an evaluator on the approved panel of PBA.

Regulation SE-6: Recovery of Outstanding Dues

To facilitate the recovery efforts, banks/DFIs are allowed to undertake cash collection/recovery at places other than their authorized places of business as stipulated in the *Fair Debt Collection Guidelines* issued by Banking Policy and Regulations Department. However, in order to prevent fraud and misappropriation of collected cash, adequate security and risk management measures (including but not limited to adequate insurance cover all the time) must be in place and this process should be appropriately documented, and audited at the bank/DFI level. The banks/DFIs are also encouraged to make use of mobile and wireless technologies/devices for instant updating of cash collection from field into their books and accounts, and also sending confirmatory SMS/alert messages to borrowers.

Regulation SE-7: General Reserve against Small Enterprise Finance

The banks/DFIs shall maintain general reserve at least equivalent to 1% of the secured SE portfolio and 2% of the unsecured SE portfolio, to protect them from the risks associated with the economic and cyclical nature of this business. The above reserve requirement shall, however, be maintained for the performing portion only of banks/DFIs' SE Portfolio.

Regulation SE-8: Classification and Provisioning for Loans/Advances

1. Banks/DFIs shall observe prudential guidelines given in this Regulation and at Annexure-II & III of these Regulations in the matter of classification of their SE asset portfolio and provisioning there-against.
2. In addition to the time-based criteria prescribed in Annexure-II, subjective evaluation of performing and non-performing credit portfolio may be made for risk assessment purpose and, where considered necessary, any account including the performing account shall be classified, and the category of classification determined on the basis of time based criteria shall be further downgraded. However, classification for program-based lending shall be done based on objective (time-based) criteria only, though banks/DFIs at their own discretion may also classify such portfolio on subjective basis.
3. In case of revolving/running finance accounts, if the borrower pays mark-up regularly without showing turn-over in the principal portion of his account, and the bank/DFI is satisfied with this conduct and are willing to roll over the facility periodically; then such account will not attract '*subjective classification'* on the basis of lower/nil activity in the principal account. However, the bank/DFI, at their discretion, can classify such accounts as per their own policy.
4. Banks/DFIs can avail the benefit of Forced Sale Value (FSV) of collateral held against loans/ advances, determined in accordance with the guidelines laid down in Annexure-III, before making any provision.
5. Party-wise details of cases, where banks/DFIs have taken the benefit of FSV shall be maintained for verification by State Bank's teams during their regular/special inspection.
6. Banks/DFIs shall review, at least on a quarterly basis, the collectability 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.
7. In case of cash recovery, other than rescheduling/restructuring, banks/DFIs may reverse specific provision held against classified assets only to the extent that required provision as determined under this Regulation is maintained.

8. Banks/DFIs will make suitable arrangements for ensuring that FSV used for taking benefit of provisioning is determined accurately as per guidelines contained in these PRs and is reflective of market conditions under forced sale situations.
9. The external auditors as part of their annual audits of banks/DFIs shall verify that all requirements as stipulated above and in Annexure II & III for classification and provisioning have been complied with. The State Bank of Pakistan shall also check the adequacy of provisioning during on-site inspection.

Regulation SE-9: Restructuring/Rescheduling of Loans

1. The banks/DFIs may reschedule/restructure problem loans as per their own policy duly approved by their Board of Directors. However, the rescheduling/restructuring of non-performing loans shall not change the status of classification of a loan/advance etc unless the following minimum conditions are met:
   i. At least 10% of the outstanding loan amount is recovered in cash and the terms and conditions of rescheduling/restructuring are fully met for a period of at least 6 months (excluding grace period, if any) from the date of such rescheduling/ restructuring**.** However, the condition of 6 Months retention period, prescribed for restructured/rescheduled loan account to remain in the classified category, shall not apply in case the borrower has repaid or adjusted in cash at least 50% of the total restructured loan amount (principal + mark-up), either at the time of restructuring agreement or later-on anytime before the completion of 6 Months period as above mentioned.
   ii. Rescheduling shall not be done simply to avoid classification.
   iii. While reporting to the Credit Information Bureau (e-CIB) of State Bank of Pakistan, such loans/advances may be shown as ‘rescheduled/restructured’ instead of ‘default’.
   iv. Restructuring/rescheduling of a loan account shall not lead to disqualification of the borrower for fresh credit facilities or enhancement in the existing limits. Such fresh loans may be monitored separately, and shall be subject to classification on the strength of their own specific terms and conditions.
   v. Where a borrower subsequently defaults (either principal or mark-up) after the rescheduled/restructured loan has been declassified by the bank / DFI, the loan shall 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.

Regulation SE-10: Minimizing Turn-Around-Time

1) It has been observed that due to the cumbersome loan processes and high Turn-Around-Time, Small Enterprises get discouraged to access formal sources of finance. To encourage

SEs to approach banks, there is high need to reduce the Turn-Around-Time for loan decision.

2) In this respect, banks/DFIs shall not take more than 30 working days for the credit approval process (from the date of receipt of complete information). In this respect, the following minimum points shall also be considered:

   i. The Pre-approval requirements and post-approval requirements (security/collateral documentation etc.) shall be advised preferably in one go.

   ii. The facility shall be disbursed only after security documentation is completed by the customer.

Chapter No: 03 Prudential Regulations for Medium Enterprise Financing

Regulation ME-1: Definition of Medium Enterprise

Medium Enterprise (ME) is a business entity, ideally not a public limited company which meets both the following parameters:

*Number of Employees	Annual Sales Turn-Over
21-250 (Manufacturing & Service MEs) 21- 50 (Trading MEs)	Above Rs 75 million and up to Rs 400 million (All types of Medium Enterprises)

*****_including contract employees_.

Regulation ME-2: Repayment Capacity and Cash Flow Based Lending

1. 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 associated with their businesses and their risk mitigants. Banks/DFIs may also use Income Estimation Models specially in program-based lending to assess repayment capacity of the borrowers.
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.

Regulation ME-3: Per Party Exposure Limit

The maximum exposure of a bank/DFI on a single Medium Enterprise shall not exceed Rs 100 million. The total exposure (including leased assets) availed by a single Medium Enterprise from the banks/DFIs shall not exceed Rs 200 million. It is expected that Medium Enterprises 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.

Regulation ME-4: Requirement of Audited Accounts

In case of lending to Medium Enterprises, banks/DFIs shall obtain a copy of financial statements duly audited by a practicing Chartered Accountant, from the Medium Enterprise who is a limited company or where the exposure of a bank/DFI exceeds Rs 10 million, for analysis and record. The banks/DFIs may also accept a copy of financial statements duly audited by a practicing Cost and Management Accountant in case of a borrower other than a public company or a private company which is a subsidiary of a public company. However, banks/DFIs may waive the requirement of obtaining audited copy of financial statements when the exposure net of liquid assets does not exceed the limit of Rs 10 million.

Regulation ME-5: Classification and Provisioning For Assets

Loans/Advances

1. Banks/DFIs shall observe the prudential guidelines given at Annexure-V & VI in the matter of classification of their ME asset portfolio and provisioning there-against. In addition to the time-based criteria prescribed in Annexure-V, subjective evaluation of performing and non-performing credit portfolio may be made for risk assessment purpose and, where considered necessary, any account including the performing account shall 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. However, classification for program based lending shall be based on objective criteria; nevertheless, banks at their own discretion may also classify such portfolio on subjective basis.
2. 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. However, the condition of one year retention period, prescribed for restructured/rescheduled loan account to remain in the classified category, shall not apply in case the borrower has repaid or adjusted in cash at least 50% of the total restructured loan amount (principal + mark-up), either at the time of restructuring agreement or later-on anytime before the completion of one year period as above mentioned. Further, the banks/DFIs may credit their income account to the extent of cash recovery made against accrued markup on the restructured/rescheduled loans.
3. The banks/DFIs shall 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 eCIB 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 shall 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.

All fresh loans granted by the banks/DFIs to a party after rescheduling/restructuring of its existing facilities may be monitored separately, and will be subject to classification under this Regulation on the strength of their own specific terms and conditions.

4. Banks/DFIs shall classify their loans/advances and make provisions in accordance with the criteria prescribed above, and further stipulated in Annexure V & VI and also keeping in view the following:
   a. Banks/DFIs may avail the prescribed benefit of FSV subject to compliance with the following conditions:
      I. The additional impact on profitability arising from availing the benefit of FSV against the pledged stocks, plant & machinery under charge, and mortgaged residential, commercial & industrial properties shall not be available for payment of cash or stock dividend.
      II. Heads of Credit of respective banks/DFIs shall ensure that FSV used for taking benefit of provisioning is determined accurately as per guidelines contained in PRs and is reflective of market conditions under forced sale situations; and
      III. Party-wise details of all such cases where banks/DFIs have availed the benefit of FSV shall be maintained for verification by State Bank's inspection team during regular/special inspection.

   b. Any misuse of FSV benefit detected during regular/special inspection of SBP shall attract strict punitive action under the relevant provisions of the Banking Companies Ordinance, 1962. Furthermore, SBP may also withdraw the benefit of FSV from banks/DFIs found involved in its misuse.

Timing of Creating Provisions

5. Banks/DFIs shall review, at least on a quarterly basis, the collectability 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

6. In case of cash recovery, other than rescheduling/restructuring, banks/DFIs may reverse specific provision held against classified assets only to the extent that required provision as determined under this Regulation is maintained. While calculating the remaining provision required to be held after cash recovery and reversal of provision there-against, the bank/ DFI shall still enjoy the benefit of netting-off the amount of liquid assets and FSV of collateral from the outstanding amount, in the light of guidelines given in this regulation. Further, the provision made on the advice of State Bank of Pakistan except where cash recovery is made shall not be reversed without prior approval of State Bank of Pakistan.

Verification by the Auditors

7. The external auditors as part of their annual audits of banks/DFIs shall verify that all requirements as stipulated above and Annexure V & VI 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.

Annexures to Prudential Regulations

ANNEXURE-I

Borrower's Basic Fact Sheet for Small Enterprises

Prescribed Under General Regulation SME-2

Date of Request: _____________

1. BUSINESS STATUS:

Proprietorship	Partnership	Other

2. BORROWER'S PROFILE:

A. Business details:

Name of business		Address	
Business Phone		Fax # (If available)	E-mail Address (If available)
Import Registration (If available)	Export Registration (If available)	Date of Establishment	Date of opening of A/c

B. OWNERS/PARTNERS/DIRECTORS DETAILS:

Name			Address	
Phone #			Fax:	E-mail Address (If available)
Office	Res.	Cell		
Computerized National Identity Card				National Tax # (If available)
Share-holding	Amount			% of Share-holding

3. NATURE OF BUSINESS:

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

Imports (if any)	Exports(if any)	Remittances effected (if any)

5. DETAILS OF FINANCING FACILITIES (BOTH BUSINESS AND PERSONAL)

S. No	Nature of Facility (Funded/Non Funded)	Name of Bank	Existing/new/ or Enhancement	Collaterals	Tenor	Amount	Amount Overdue (if any)

6. DETAILS OF WRITE-OFF, RESCHEDULING/ RESTRUCTURING, (IF ANY)

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

____

BORROWER'S SIGNATURE

ANNEXURE-II

Small Enterprise Financing (Regulation SE-8)
Guidelines in the Matter of Classification
And Provisioning For Assets

All Financing Facilities (including Short, Medium and Long Term)

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 by 90 days or more from the due date.	Unrealized mark-up/interest to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized markup/ interest already taken to income account to be reversed and kept in Memorandum Account.	Provision of 10% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge and mortgaged residential, commercial and industrial properties (land & building only) to the extent allowed in Annexure III.
2. Substandard.	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge and mortgaged residential, commercial and industrial properties (land & building only) to the extent allowed in Annexure III.
3. Doubtful.	Where mark-up/ interest or principal is overdue by 1 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 Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge and mortgaged residential, commercial and industrial properties (land &

			building only) to the extent allowed in Annexure III.
4. Loss.	(a) Where mark-up/ interest or principal is overdue by 18 months or more from the due date.	As above	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge and mortgaged residential, commercial and industrial properties (land & building only) to the extent allowed in Annexure III.
	(b) Where Trade Bills (Import/Export or Inland Bills) are not paid/adjusted within 180 days of the due date.	As above	As above.

Note:

i. *Classified loans/advances that have been guaranteed by the Government would not require provisioning, however, mark up/interest on such accounts to be taken to Memorandum Account instead of Income Account.*
ii. *Revised Classification and Provisioning requirements are applicable with immediate effect for the fresh financing facilities. However, since the banks/DFIs need to segregate their existing SME portfolio according to the new definitions and revised classification criteria, Banks/DFIs are allowed a maximum implementation period upto September 30, 2013 for the purpose for existing portfolio.*

ANNEXURE-III

Prudential Regulations for Small Enterprises Financing

Uniform Criteria for Determining the Value of Pledged Stock, Plant & Machinery under Charge and Mortgaged Properties (Regulation SE-8)

1. Banks/DFIs are allowed to take the benefit of Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge, and mortgaged residential, commercial and industrial properties held as collateral against Non Performing Loans (NPLs) for calculating provisioning requirement as tabulated below:

Category of Asset	Forced Sale Value Benefit allowed from the date of classification
Mortgaged residential, commercial and industrial properties (Land & building only)	• 75% for first year • 60% for second year • 45% for third year • 30% for fourth year, and • 20% for fifth year
Plant & Machinery under charge	• 30% for first year • 20% for second year, and • 10% for third year
Pledged stock	• 40% for first, second, and third year

The benefit of FSV against NPLs shall not be available after the period prescribed above.

2. While taking benefit of FSV and arriving at its value, the following minimum points shall be taken into account:

a) At the time of classification, the valuation shall not be more than 3 years old.
b) Valuations shall be carried out by an independent professional evaluator who should be listed on the panel of evaluators maintained by the Pakistan Banks' Association (PBA).
c) Only liquid assets, pledged stock, plant & machinery under charge and property having registered or equitable mortgage shall be considered for taking benefit for provisioning, provided no NOC for creating further charge to another bank/DFI/NBFC has been issued by the bank/DFI. Assets having pari-passu charge shall be considered on proportionate basis of the outstanding amount.
d) Hypothecated assets and assets with second charge & floating charge shall not be considered for taking the benefit for provisioning purposes.
e) The evaluator, while assigning any values to the pledged stock, plant and machinery under charge and mortgaged property, 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 pledged stock, plant and machinery under charge and mortgaged property so determined by the evaluators have to be reasonably good estimate of the amount that could currently be obtained by selling such assets in a forced/distressed sale condition. The evaluators should also mention in

their report the assumptions made, the calculations/formulae/basis used and the method adopted in determination of the values i.e. the forced sales value (FSV).

f) In cases where the evaluators are not allowed by the borrowers to enter in their premises, the benefit of FSV shall not be accepted for provisioning purposes.

g) The additional impact on profitability arising from availing the benefit of FSV against pledged stocks, plant and machinery under charge, and mortgaged residential, commercial and industrial properties (land and building only) shall not be available for payment of cash or stock dividend.

3. Any misuse of FSV benefit detected during regular/special inspection of SBP shall attract strict punitive action under the relevant provisions of the Banking Companies Ordinance, 1962. Furthermore, SBP may also withdraw the benefit of FSV from banks/DFIs found involved in its misuse.

4. Various categories of assets to be considered for valuation 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. Moreover, valuation of shares pledged against loans/advances shall be considered only if such shares are in dematerialized form in the Central Depository Company of Pakistan (CDC), otherwise these will not be admissible for deduction as liquid assets while determining required provisions.

b) Mortgaged Property and Plant & Machinery under Charge:

Valuation of residential, commercial and industrial property (land and building only) and plant & machinery would be accepted as determined by the evaluators in accordance with the criteria given above.

c) Pledged Stocks:

In case of pledged stocks of perishable and non-perishable goods, forced sale value should be provided by evaluators, and such valuation should not be more than six months old, at each balance sheet date. The goods should be perfectly pledged, the operation of the godown(s) or warehouse(s) should be in the control of the bank/DFI and relevant documents should be available. In case of perishable goods, the evaluator should also give the approximate date of complete erosion of value of pledged stock.

ANNEXURE-IV

Borrower's Basic Fact Sheet- for Medium Enterprises
Prescribed Under General Regulation SME-2

Date of Request._______________

(TO BE COMPLETED IN CAPITAL LETTERS OR TYPEWRITTEN)

1. BORROWER'S PROFILE:

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

3. MANAGEMENT:

A) EXECUTIVE DIRECTORS/PARTNERS:			
Name	Address	CNIC #	Phone #
1.			
2.			
B) NON-EXECUTIVE DIRECTORS/PARTNERS:			
Name	Address	CNIC #	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 3 YEARS:

Name of Financial Institution	Amount during 1st Year		Amount during 2nd Year		Amount during 3rd 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 FINANCIAL INSTITUTIONS:

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

15. DETAILS OF PERSONAL GUARANTEES PROVIDED BY THE DIRECTORS/PARTNERS ETC. TO FINANCIAL INSTITUTIONS 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 ME-4 to be submitted with the Loan Application Form (LAF).

22. Memorandum and Articles of Association, By-laws etc. to be submitted by the borrower along with 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)

Note: Sole proprietorship borrowers are exempt from the requirement of seal/stamps on BBFS

ANNEXURE-V

Medium Enterprise Financing (Regulation ME-5)
Guidelines in the Matter of Classification
And Provisioning For Assets

All Financing Facilities (including Short, Medium and Long Term)

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE
(1)	**(2)**	**(3)**	**(4)**
1. Substandard.	Where mark-up/ interest or principal is overdue by 90 days or more from the due date.	Unrealized mark-up/interest to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized mark up/interest already taken to income account to be reversed and kept in Memorandum Account.	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge and mortgaged residential, commercial and industrial properties (land & building only) to the extent allowed in Annexure VI.
2. Doubtful.	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge and mortgaged residential, commercial and industrial properties (land & building only) to the extent allowed in Annexure VI.

3. Loss.	(a) Where mark-up/ interest or principal is overdue by one year or more from the due date.	As above.	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge and mortgaged residential, commercial and industrial properties (land & building only) to the extent allowed in Annexure VI.
	(b) Where Trade Bills (Import/Export or Inland Bills) are not paid/adjusted within 180 days of the due date.	As above.	As above.

Note:

1. *Classified loans/advances that have been guaranteed by the Government would not require provisioning, however, mark up/interest on such accounts to be taken to Memorandum Account instead of Income Account.*

ANNEXURE-VI

Prudential Regulations for Medium Enterprise Financing
Uniform Criteria for Determining the Value of Pledged Stock, Plant & Machinery under Charge And Mortgaged Properties (Regulation Me-5)

1. Only liquid assets, pledged stock, plant & machinery under charge and property having registered or equitable mortgage shall be considered for taking benefit for provisioning, provided no NOC for creating further charge to another bank/DFI/ NBFC has been issued by the bank/DFI. The aforesaid assets having pari-passu charge shall be considered on proportionate basis of outstanding amount.

2. Hypothecated assets and assets with second charge & floating charge shall not be considered for taking the benefit for provisioning.

3. Banks/DFIs are allowed to take the benefit of Forced Sale Value (FSV) of pledged stocks, plant & machinery under charge, and mortgaged residential, commercial and industrial properties held as collateral against Non Performing Loans (NPLs) for calculating provisioning requirement as tabulated below:

Category of Asset	**Forced Sale Value Benefit allowed from the date of classification**
Mortgaged residential, commercial and industrial properties (land & building only)	• 75% for first year • 60% for second year • 45% for third year • 30% for fourth year, and • 20% for fifth year
Plant & Machinery under charge	• 30% for first year • 20% for second year, and • 10% for third year
Pledged stock	• 40% for first, second, and third year

The benefit of FSV against NPLs shall not be available after the period prescribed above.

4. Valuations shall be carried out by an independent professional evaluator who should be listed on the panel of evaluators maintained by the Pakistan Banks' Association (PBA). For selection and listing of the evaluators, PBA shall lay down the minimum eligibility criteria with the prior approval of the State Bank of Pakistan. The evaluator while assigning any values to the pledged stock, plant & machinery under charge and mortgaged property, 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 pledged stock, plant & machinery under charge and mortgaged property so determined by the evaluators 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 evaluators should also mention in their report the assumptions

made, the calculations/formulae/basis used and the method adopted in determination of the values i.e. the forced sale value (FSV).

5. The valuation process shall 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. Full scope valuation shall be valid for three years from the date of last Full-scope valuation.

6. The following may be noted in respect of the Desktop and Full-Scope Valuations:

- Desktop Evaluation is defined as "an Interim Brief Review of Full-Scope Evaluation, so that any significant change in the factors, on which the full-scope valuation was based, is accounted for and brought to the notice of the lending bank/DFI."

- In case the loans exceed Rs 100 million, the Desktop Valuation shall be done by the same evaluator, who had conducted the Full-Scope Valuation (the evaluator should be on the approved panel of the PBA) whereas for loans below this threshold, the Desktop Valuation may be done by the banks/DFIs themselves or by the approved evaluators. For conducting Desktop evaluation, the evaluators shall pay a short visit to the borrower's site. The bank's/DFI's responsibility in this respect will be to ensure that the evaluator is contacted for conducting Desktop Valuation, and is provided all necessary information which is materially important for the interim review.

- The Desktop Valuation shall be used for determining any additional provisioning requirement only and will not be applied for reducing the provisioning requirement, assessed on the basis of Full-scope Valuation.

- In cases where the evaluators are not allowed by the borrowers to enter in their premises, the Full-scope Valuation, conducted as such, will not be accepted for provisioning benefit.

7. State Bank of Pakistan may check the valuations of the assets under mortgage/charge, 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 including, interalia, withdrawal of FSV benefit.

8. Various categories of assets to be considered for valuation would be as under (no other assets shall be taken into consideration):

a) <u>Liquid Assets:</u>
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. Moreover, valuation of shares pledged against loans/advances shall be considered only if such shares are in dematerialized form in the Central Depository Company of Pakistan (CDC), otherwise these will not be admissible for deduction as liquid assets while determining required provisions.

b) <u>Mortgaged Property and Plant & Machinery under Charge:</u>
Valuation of residential, commercial and industrial property (land and building only) and plant & machinery would be accepted as determined by the evaluators in accordance with the criteria given above.

c) <u>Pledged Stocks:</u>
In case of pledged stocks of perishable and non-perishable goods, forced sale value should be provided by evaluators, and such valuation should not be more than six months old, at each balance sheet date. The goods should be perfectly pledged, the operation of the godown(s) or warehouse(s) 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 evaluator should also give the approximate date of complete erosion of value.

ANNEXURE-VII

DEFINITIONS OF IMPORTANT TERMS

For the purpose of these regulations:

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

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

3. **Contingent liability** means:
   (a) a possible obligation that arises from past events and whose existence shall 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.

4. **DFI** means Development Financial Institution and includes 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, Pak-Brunei Investment Company Limited, Pak-China Investment Company Limited, Pak- Iran Joint Investment Company Limited, House Building Finance Corporation and any other financial institution notified under Section 3-A of the Banking Companies Ordinance, 1962.

5. **Documents** include vouchers, cheques, bills, pay-orders, promissory notes, securities for leases/advances, and claims by or against the bank**/**DFI or other papers supporting entries in the books of a bank/DFI.

6. **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.

7. **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.

8. **Government Securities** shall include such types of Pak. Rupee obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government as the Federal Government may, by notification in the Official Gazette, declare, to the extent determined from time to time, to be Government Securities.

9. **Group** means persons, whether natural or juridical, if one of them or his dependent family members or its subsidiary, have control or hold substantial ownership interest over the other. For the purpose of this:

(a) **Subsidiary** shall 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 shareholding of more than 25% by a person and/or by his dependent family members, which shall include his/her spouse, dependent lineal ascendants and descendants and dependent brothers and sisters. However, shareholding in or by the Government owned entities and financial institutions shall not constitute substantial ownership/affiliation, for the purpose of these regulations.

10. **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, gold ornaments, gold bullion, certificates of deposit, shares of listed companies which are actively traded on the stock exchange, NIT Units, certificates of mutual funds, Certificates of Investment (COIs) issued by DFIs/NBFCs rated at least ‘A’ by a credit rating agency on the approved panel of State Bank of Pakistan, listed TFCs rated at least ‘A’ by a credit rating agency on the approved panel of State Bank of Pakistan and certificates of asset management companies for which there is a book maker quoting daily offer and bid

rates and there is active secondary market trading. These assets with appropriate margins should be in possession of the banks/DFIs with perfected lien.

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

The inter-branch indemnity/guarantee issued by the bank's overseas branch in favor of its sister branch in Pakistan, would also be treated at par with liquid assets, provided the bank is rated 'A' and above or equivalent either by Standard & Poors, Moody's or Fitch-Ibca. The indemnity for this purpose should be similar to a guarantee i.e. unconditional and demand in nature.

11. **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.

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

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

14. **PBA** means Pakistan Banks Association.

15. **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.

16. **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.

    The banks/DFIs may also take exposure against Trust Receipt. They are, however, free to take collateral/securities, to secure their risks/exposure, in addition to the Trust Receipt.

    Banks/DFIs shall be free to decide about obtaining security/collateral against the L/C facilities for the interim period, i.e. from the date of opening of L/C till the receipt of title documents to the goods.

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