PRUDENTIAL REGULATIONS FOR SMALL AND MEDIUM ENTERPRISES FINANCING

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BANKING POLICY & REGULATIONS DEPARTMENT
STATE BANK OF PAKISTAN

THE TEAM

NAME	DESIGNATION	TELEPHONE NO. & E-MAIL
Jameel Ahmed	Executive Director	(92-21) 9212507 jameel.ahmed@sbp.org.pk
Syed Irfan Ali	Director (BP & RD)	(92-21) 9213580 syed.irfan@sbp.org.pk
Muhammad Saleem	Senior Joint Director (BP & RD)	(92-21) 9212511 muhd.saleem@sbp.org.pk
Amanullah Ogahi	Jr. Joint Director (BP & RD)	(92-21) 2453578 amanullah.ogahi@sbp.org.pk
Ahmed Mukhtar	Assistant Director (BP & RD)	(92-21) 2453519 ahmad.mukhtar@sbp.org.pk

Website Address: www.sbp.org.pk

C O N T E N T S

P R E F A C E

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

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

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

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

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

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

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

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

SYED IRFAN ALI
Director
Banking Policy & Regulation Department

PART – A

<u>D E F I N I T I O N S</u>

For the purpose of these regulations:

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

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

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

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

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

5. **DFI** means Development Financial Institution and includes the Pakistan Industrial Credit and Investment Corporation (PICIC), the Saudi Pak Industrial and Agricultural Investment Company Limited, the Pak Kuwait Investment Company Limited, the Pak Libya Holding Company Limited, the Pak Oman Investment Company (Pvt.) Limited, Investment Corporation of Pakistan, House Building Finance Corporation and any other financial institution notified under Section 3-A of the Banking Companies Ordinance, 1962.

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

7. **Equity of the Bank / DFI** means Tier-I Capital or Core Capital and includes paid-up capital, general reserves, balance in share premium account, reserve for issue of bonus shares and retained earnings / accumulated losses as disclosed in latest annual audited financial statements. In case of branches of foreign banks operating in Pakistan, equity will mean capital maintained, free of losses and provisions, under Section 13 of the Banking Companies Ordinance, 1962.

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

   The Preference Shares, only with the following features, will also be included in the equity of the borrower:

   - There should not be any provision for redemption or the redemption should be at the option of the issuer.
   - In case the issuer is given an option to redeem the preference shares, as per agreed terms and conditions, the issuer will redeem the share only through a sinking fund created out of the profits of the company. Further, the sinking fund created for this purpose would not be calculated towards the equity of the issuer.
   - The terms and conditions should not give rise to a contractual obligation on the part of the issuer to deliver another financial asset or exchange another financial instrument under conditions that are or can be potentially unfavorable to the issuer. However, an

option to convert preference shares into common shares may be included in the features of the preference shares.

- The terms and conditions of the preference shares should not be such as to compel the issuer economically, financially or otherwise to redeem the shares.
- Payment and distribution of dividend to the holders of preferred shares, whether cumulative or non-cumulative, should be at the discretion of the issuer.

Revaluation reserves will remain part of the equity for first three years only, from the date of asset revaluation, during which time the borrower will strengthen its equity base to enable it to avail facilities without the benefit of revaluation reserves. However, if a borrower gets revaluation during the three years period, the borrower will be allowed the benefit from fresh revaluation, to the extent of increase in revaluation reserves, but restricting the benefit of such incremental value to 3 years only. Similarly, if after 3 years, the borrower again gets revaluation of the assets with resultant addition in their value, the benefit of such revaluation may also be allowed for the next 3 years, again to the extent of increase in revaluation reserves.

The revaluation reserves to be eligible for benefit should be calculated by the valuers on the approved panel of the PBA. If the bank / DFI obtains copy of accounts as per requirement in Prudential Regulation R-3, then such revaluation reserves should appear in the said accounts, and in such case, no parallel calculation by the banks / DFIs for amortization purposes will be required. In case of no requirement of copy of accounts, the borrower may still be given the benefit of revaluation reserves in the way mentioned above, but the bank / DFI will calculate the amortization of the same independently.

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

    (i) Any form of financing facility extended or bills purchased/ discounted except ones drawn against the L/Cs of banks / DFIs rated at least 'A' by Standard & Poor, Moody's, Fitch-Ibca, Japan Credit Rating Agency (JCRA) or credit rating agency on the approved panel of State Bank of Pakistan and duly accepted by such L/C issuing banks / DFIs

    (ii) Any financing facility extended or bills purchased/discounted on the guarantee of the person.

    (iii) Subscription to or investment in shares, Participation Term Certificates, Term Finance Certificates or any other Commercial Paper by whatever name called (at book value) issued or guaranteed by the persons.

    (iv) Credit facilities extended through corporate cards.

    (v) Any financing obligation undertaken on behalf of the person under a letter of credit including a stand-by letter of credit, or similar instrument.

    (vi) Loan repayment financial guarantees issued on behalf of the person.

    (vii) Any obligations undertaken on behalf of the person under any other guarantees including underwriting commitments.

    (viii) Acceptance / endorsements made on account.

    (ix) Any other liability assumed on behalf of the client to advance funds pursuant to a contractual commitment.

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

11. **Government Securities** shall include such types of Pak. Rupee obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled,

directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government as the Federal Government may, by notification in the Official Gazette, declare, to the extent determined from time to time, to be Government Securities.

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

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

    (c) **Substantial ownership / affiliation** means beneficial shareholding of more than 25% by a person and/or by his dependent family members, which will 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 will not constitute substantial ownership / affiliation, for the purpose of these regulations.

13. **Liquid Assets** are the assets which are readily convertible into cash without recourse to a court of law and mean encashment / realizable value of government securities, bank deposits, certificates of deposit, shares of listed companies which are actively traded on the stock exchange, NIT Units, certificates of mutual funds, Certificates of Investment (COIs) issued by DFIs / NBFCs rated at least 'A' by a credit rating agency on the approved panel of State Bank of Pakistan, listed TFCs rated at least 'A' by a credit rating agency on the approved panel of State Bank of Pakistan and certificates of asset management companies for which there is a book maker quoting daily offer and bid rates and there is active secondary market trading. These assets with appropriate margins should be in possession of the banks / DFIs with perfected lien.

    Guarantees issued by domestic banks / DFIs when received as collateral by banks / DFIs will 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, Fitch-Ibca or Japan Credit Rating Agency (JCRA), 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, Fitch-Ibca or Japan Credit Rating Agency (JCRA). The indemnity for this purpose should be similar to a guarantee i.e. unconditional and demand in nature.

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

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

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

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

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

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

    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 will 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.

20. **Subordinated Loan** means an unsecured loan, extended to the borrower for a minimum original maturity period of 5 years, subordinate to the claim of the bank / DFI taking exposure on the borrower, and documented by a formal sub-ordination agreement between provider of the loan and the bank / DFI. The loan shall be disclosed in the annual audited financial statements of the borrower as subordinated loan.

21. **Small and Medium Enterprise (SME)** means an entity, ideally not a public limited company, which does not employ more than 250 persons (if it is manufacturing / service concern) and 50 persons (if it is trading concern) and also fulfills the following criteria of either ‘a’ and ‘c’ or ‘b’ and ‘c’ as relevant:

    (a) A trading / service concern with total assets at cost excluding land and building upto Rs 50 million.

    (b) A manufacturing concern with total assets at cost excluding land and building upto Rs 100 million.

    (c) Any concern (trading, service or manufacturing) with net sales not exceeding Rs 300 million as per latest financial statements.

    An Individual, if he or she meets the above criteria, can also be categorized as an SME.

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

PART – B
R E G U L A T I O N S

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

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

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

REGULATION R-2
PERSONAL GUARANTEES

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

REGULATION R-3
LIMIT ON CLEAN FACILITIES

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

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

REGULATION R-4
SECURITIES

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

REGULATION R-5
MARGIN REQUIREMENTS

Banks / DFIs are free to determine the margin requirements on 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, import of which are banned by the Government. Banks / DFIs are advised not to open import letter of credit for these items in any case till such time the lifting of ban on any such item is notified by the State Bank of Pakistan.

2. Banks / DFIs will 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, will also continue to remain applicable.

3. 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.

4. 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 SMEs Financing.

REGULATION R-6
PER PARTY EXPOSURE LIMIT

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

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

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

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

REGULATION R-8
MINIMUM CONDITIONS FOR TAKING EXPOSURE

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

2. Banks / DFIs are encouraged to refer the prospective SME borrower to SME Associations for obtaining information about its character and credit worthiness. The information so obtained may be helpful for banks/DFIs, especially in those circumstances where no information is available from CIB of State Bank of Pakistan.

3. Banks / DFIs shall, as a matter of rule, obtain a copy of financial statements duly audited by a practicing Chartered Accountant, relating to the business of every borrower who is a limited company or where the exposure of a bank / DFI exceeds Rs 10 million, for analysis and record. 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 copy of financial statements when the exposure net of liquid assets dose not exceed the limit of Rs 10 million. Further, financial statements signed by the borrower will suffice where the exposure is fully secured by liquid assets.

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

REGULATION R-9
PROPER UTILIZATION OF LOAN

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

REGULATION R-10

RESTRICTION ON FACILITIES TO RELATED PARTIES

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

R-11

CLASSIFICATION AND PROVISIONING FOR ASSETS

LOANS / ADVANCES

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

2. In addition to the time-based criteria prescribed in Annexure-III, subjective evaluation of performing and non-performing credit portfolio shall be made for risk assessment and, where considered necessary, any account including the performing account will be classified, and the category of classification determined on the basis of time based criteria shall be further downgraded. Such evaluation shall be carried out on the basis of credit worthiness of the borrower, its cash flow, operation in the account, adequacy of the security, inclusive of its realizable value and documentation covering the advances.

3. The rescheduling / restructuring of non-performing loans shall not change the status of classification of a loan / advance etc. unless the terms and conditions of rescheduling / restructuring are fully met for a period of at least one year (excluding grace period, if any) from the date of such rescheduling / restructuring and at least 10% of the outstanding amount is recovered in cash. However, the condition of one year retention period, prescribed for restructured / rescheduled loan account to remain in the classified category, will 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 during the grace period if any.

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

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

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

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 portfolio and make provisions in accordance with the criteria prescribed above.

a. Banks are allowed to take the benefit of 30 percent of FSV of pledged stocks and mortgaged commercial and residential properties held as collateral against all NPLs for three years from the date of classification for calculating provisioning requirement w.e.f. 31-12-2008. . For the purpose of determination of FSV, revised Annexure-V of PR for Corporate/Commercial Banking shall be followed.

b. Banks/DFIs may avail the above benefit of FSV subject to compliance with the following conditions:

i) The additional impact on profitability arising from availing the benefit of FSV against pledged stocks and mortgaged commercial and residential 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.

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 teams during regular /special inspection.

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

REVERSAL OF PROVISION:

6. In case of cash recovery, other than rescheduling / restructuring, banks / DFIs may reverse specific provision held against classified assets, subject to the following:

i) In case of Loss account, reversal may be made to the extent that the remaining outstanding amount of the classified asset is covered by minimum 100% provision.
ii) In case of Doubtful account, reversal may be made to the extent that the remaining outstanding amount of the classified asset is covered by minimum 50% provision.
iii) In case of Substandard account, reversal may be made to the extent that the remaining outstanding amount of the classified asset is covered by minimum 25% provision.

While calculating the remaining provision required to be held after cash recovery and reversal of provision there-against, the banks / DFIs will enjoy the benefit of netting-off the amount of liquid assets from the outstanding amount, in the light of guidelines given in this regulation. However, the provision made on the advice of State Bank of Pakistan will not be reversed without prior approval of State Bank of Pakistan.

VERIFICATION BY THE AUDITORS:

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

<u>ANNEXURE I</u>

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

Date of Request._______________

(TO BE COMPLETED IN CAPITAL LETTERS OR TYPEWRITTEN)

1. BORROWER'S PROFILE:

Name	Address

Phone #		Fax #	E-mail Address
Office	Res.		

Computerized National Identity Card #	National Tax #	Sales Tax #

Import Registration #	Export Registration #	Date of Establishment	Date of opening of A/c.

2. DETAILS OF DIRECTORS/OWNERS/PARTNERS:

Name	Address

Phone #		Fax #	E-mail Address
Office	Res.		

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 THREE 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 CONCERNED FI:

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

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

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

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

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

17. SHARE PRICES OF THE BORROWING ENTITY:

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

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

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

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

Name of Financial Institution	Amount

20. Details of payment schedule if term loan sought.

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

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

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

CHIEF EXECUTIVE'S/ BORROWER'S SIGNATURE & STAMP

COUNTER SIGNED BY:

AUTHORISED SIGNATURE & STAMP (BANK / DFI OFFICIAL)

Note. Individuals and Sole Proprietorship borrowers are exempt from requirement of Seal/Stamp on BBFS.

ANNEXURE II

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

Date of Request.______________

(TO BE COMPLETED IN CAPITAL LETTERS OR TYPEWRITTEN)

1. BORROWER'S PROFILE:

Name		Address	
Phone #		Fax #	E-mail Address
Office	Res.		
Computerized National Identity Card #			National Tax #
Father's Name		Father's Computerized National Identity Card #	

2. REFERENCES (AT LEAST TWO):

Name		Address	
Phone #		Fax #	E-mail Address
Office	Res.		
Computerized National Identity Card #			National Tax #

3. NATURE OF BUSINESS/ PROFESSION:

Industrial	Commercial	Agricultural	Services	Any other

4. EXISTING LIMITS AND STATUS:

	Amount	Expiry Date	Status		
			Regular	Amount Over-due (if any)	Amount Rescheduled/ Restructured (if any)
Fund Based					
Non-Fund Based					

5. REQUESTED LIMITS:

	Amount	Tenor
Fund Based		
Non-Fund Based		

6. Details of payment schedule if term loan sought.

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

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

APPLICANT'S SIGNATURE & STAMP

COUNTER SIGNED BY:

AUTHORISED SIGNATURE & STAMP
(BANK / DFI OFFICIAL)

Note. Individuals and Sole Proprietorship borrowers are exempt from requirement of Seal/Stamp on BBFS.

ANNEXURE-III

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

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 30% of the Forced Sale Value (FSV) of pledged stocks and mortgaged residential and commercial properties (see Note 2 below).
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 30% of the Forced Sale Value (FSV) of pledged stocks and mortgaged residential and commercial properties (see Note 2 below).
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 30% of the Forced Sale Value (FSV) of pledged stocks and mortgaged residential and commercial properties (see Note 2 below). Benefit of FSV against NPLs shall not be available after 3 years from the date of classification of the Loan/Advance.
	(b) Where Trade Bills (Import/Export or Inland Bills) are not paid/adjusted within 180 days of the due date.	As above	As above.

Notes :

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.

2) FSV shall be determined in accordance with the guidelines contained in Annexure-IV to these Regulations.

ANNEXURE-IV

UNIFORM CRITERIA FOR DETERMINING THE VALUE OF PLEDGED STOCK AND MORTGAGED RESIDENTIAL & COMMERCIAL PROPERTIES REGULATION (R-11)

Only liquid assets, pledged stock, and residential & commercial 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 bank / DFI. The aforesaid assets having pari-passu charge shall be considered on proportionate basis of outstanding amount.

2. Hypothecated assets, industrial land and building together with plant and machinery thereon, and assets with second charge and floating charge shall not be considered for taking the benefit for provisioning.

3. 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 this purpose. PBA shall lay down the minimum eligibility criteria with the prior approval of the State Bank of Pakistan for placement of evaluators on the panel to be maintained by it. The evaluator while assigning any values to the pledged stock and mortgaged residential and commercial 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 and mortgaged residential and commercial 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 sales value (FSV).

4. The valuation process will include conducting a 'Full-scope Valuation' of the assets in the first year and then followed by 'Desktop Valuations' in the second and third year. Full scope valuation shall be valid for three years from the date of last valuation; and, at the time of classification, the Full scope valuation shall not be more than one year old.

5. The following may be noted in respect of the Desktop and Full-scope Evaluations:

- 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 will be done by the same evaluator, who had conducted the full-scope evaluation (the evaluator should be on the approved panel of the PBA) whereas for loans below this threshold, the Desktop evaluation may be done by the banks / DFIs themselves or by the approved evaluators. For conducting Desktop evaluation, the evaluators will pay a short visit to the bank / DFI and the borrower's site. The bank's / DFI's responsibility in this respect will be to ensure that the evaluation is contacted for conducting Desktop Evaluation, and will provide all necessary information to the evaluators, which are materially important for the interim review (Desktop Evaluation).
- The Desktop Evaluation shall be used for determining any additional provisioning requirement and thus the same shall not result in reducing the provisioning requirement, assessed on the basis of full scope evaluation.
- In cases where the evaluators are not allowed by the borrowers to enter in their premises, the full-scope evaluation, conducted as such, will not be accepted for provisioning benefit.

6. State Bank may check the valuations of the mortgaged assets through an independent evaluator, on random basis, to verify the reasonableness of the valuations. The unjustified

differences in the valuations of the banks / DFIs and State Bank of Pakistan shall render the concerned bank/DFI and evaluator to penal actions including, interalia, withdrawal of FSV benefit.

7. The categories of pledged stock and mortgaged residential and commercial property to be considered for valuation along with discounting factors to be applied would be as under (no other assets shall be taken into consideration):

a) Liquid Assets:

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

b) Mortgaged residential and commercial property:

Valuation of residential and commercial property (excluding industrial land and building) 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, which 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 when these are expected to be of no value.