<u>Annexure to MFD Circular No 07 dated December 31, 2007</u>

Long Term Financing Facility (LTFF) for
<u>Imported and Locally Manufactured Plant & Machinery</u>

1. Scope and Eligibility:

a) Under this facility, Participating Financial Institutions (PFIs) shall provide long term local currency finance for imported and locally manufactured new plant and machinery to be used by the export oriented projects (see Schedule 1 for list of sectors eligible for financing under this facility). The facility shall be available to the export oriented projects only if their annual export is equivalent to US $5 million or at least 50% of the sales whichever is lower.

b) Financing shall be available through PFIs which include commercial banks, Islamic Banks {subject to (ii) below} and DFIs.

   i) Banks / DFIs already approved as PFIs for the purposes of LTF-EOP and LMM Schemes shall be treated as PFIs for the purpose of this facility. Other banks/ DFIs can also lodge their requests to the concerned department of SBP for seeking the status of a PFI which shall be processed as per SBP's criteria.

   ii) Provision of the facility through Islamic Banks is also subject to availability of Shariah Compliant compatible products for end users as also for claiming refinance for LTFF, approved by the bank's Sharia Advisor and SBP's Shariah Board.

c) Financing under the facility shall be available to the extent of the C&F value of the imported new plant and machinery and ex-factory/showroom price of the new locally manufactured machinery to be purchased by the eligible borrowers.

d) Export oriented SME borrowers (as defined in Prudential Regulations for SMEs), may purchase imported machinery from the commercial importers or authorized dealers of the foreign manufacturers in Pakistan and authorized suppliers in case of locally manufactured machinery and plant. While providing facilities under the Scheme to SME borrowers the PFIs, however, will ensure that financing under the facility, when taken together with other borrowings, does not exceed the borrowing ceiling fixed for SMEs under the SMEs Prudential Regulations.

2. Quantum of refinance and the rate of service charges for end users:

a) Each year State Bank shall announce maximum amount upto which it will provide refinance to all the PFIs. This limit shall then be assigned to each PFI on the basis of a criteria linked to the performance of the PFI as an entity, as assessed by our Banking Inspection and Offsite Surveillance and Enforcement Departments, its equity, appetite for the long term financing as also performance of its borrowers to whom the facilities on long term basis have already been provided. The limit so fixed shall be allocated on first cum first provided basis.

b) The State Bank may consider, if necessary, to provide refinance to the PFIs on first cum first serve basis keeping in view the overall allocation without assigning specific PFI wise limits. However in case this option is adopted, State Bank will inform the PFIs accordingly through a circular.

c) Each year the SBP shall decide the ratio of refinance to be provided under this Facility keeping in view growth in reserve money. However, for the current year the SBP shall provide refinance to each PFI under the Facility, to the extent of 70% of the amount disbursed by it in an individual case.

d) The rate of service charge at which SBP will provide refinance to the PFI shall be determined on the basis of/ reference to the average of weighted average yields of last two auctions of 3, 5 and 10 years PIBs subject to the following;

   i) The service charges shall be announced for each fiscal year and shall remain valid for a period of one year from 1st July to 30th June.

   ii) The rate of service charges once fixed shall remain locked-in for the entire duration of the loan, provided the borrowers continue to repay all scheduled installments at the respective due dates. Similarly, in cases where the loan amount has not been disbursed in full during the validity of an applicable rate, the un-disbursed amount shall attract the new rate of finance/refinance applicable on the date of its disbursement by the PFI.

   iii) The State Bank shall provide refinance to each PFI on service charge basis in terms of Section 22 read with Section 17 (2) (d) of State Bank of Pakistan Act 1956.

e) PFIs shall be permitted to charge a maximum spread of 1.5%, 2.5% & 3% p.a. for financing upto 3, 5 & 10 years respectively from the borrowers, availing finance under the Facility, where refinance has been provided by the State Bank.

f) The maximum rate of mark up on the portion of loan provided by PFI from its own sources shall be equivalent to the rate announced by the State Bank for end users for the respective tenure. However, the borrower will be required to assume the cost of hedging interest rate risk on the portion of the loan to be provided by the PFI besides it will also be subject to prepayment penalty, which shall not be more than the cost of hedging the interest rate risk.

g) The PFIs would be liable to make payment of service charges on refinance availed from the respective office of the SBP BSC on quarterly basis on the first working day following the calendar quarter to which they relate.

3. Period of Financing and its repayment:

a) The maximum period for which the financing under the scheme can be availed shall not be more than 10 years including a maximum grace period of 2 years. Where financing is provided for a period of upto 5 years the grace period shall not be more than one year.

b) The repayment of financing (principal amount of loan) availed under the facility shall be made by the borrowers in equal half yearly / quarterly installments depending upon the tenure for which the facility is availed. PFIs, however, shall not be permitted to require borrowers to pay mark up / service charges at a frequency of less than three months except at the time of pre-payments/liquidation of loan.

c) In case a borrower repays the loan amount or its installment, in part or in full, on or before the due date(s), the PFIs shall adjust the loan amount on prorata basis keeping in view the share of financing made by them through their own sources and refinance availed from SBP. They shall repay the SBP's portion of loan amount so received from the borrower immediately, but not later than two working days, to the concerned office of SBP-BSC, failing which fine for late adjustment of amount will be charged from the PFI at the rate as specified in Para 8 below.

d) As the refinance granted to the PFIs shall be recovered on the due date reported to us as per the original repayment schedule, from the account of the PFI maintained with the concerned office of the SBP BSC (Bank), thus in case the borrowers fail to make repayment of the amount of installment as per the original repayment schedule, the PFI will be entitled to charge normal rate of mark up of such overdue principal amount besides taking other actions to recover the same as are incidental to such defaults.

e) Where a PFI has allowed rescheduling of a loan, the borrower shall be liable to make payment of mark up at the rate prescribed under the Facility on the date of such rescheduling, or the original rate whichever is higher. However the principal amount of refinance will only be rescheduled so as to be repaid within a maximum period of 10 years from the date of original disbursement. Any rescheduling that allows the borrowers to avail funding facilities under the Facility for a longer period will not be considered for the purpose of this Facility and in all such cases the entire loan would be considered to have been repaid within the period of 10 years.

4. Sanctioning and disbursement of loans:

a) PFI shall not take more than two months in evaluating an application for financing under the facility from the date of receipt of complete information from the borrower. Where the request is declined, the PFI will explicitly apprise the reason for rejecting the application to the prospective borrower. The PFIs shall undertake due diligence process as per their lending policies before sanction of the loan to protect their interests subject to the respective Prudential Regulations prescribed by the SBP for each type of borrower.

b) PFIs shall at all times remain within the limits assigned to them for disbursements under the facility in a given financial year. Facilities should not be sanctioned in favour of borrowers in anticipation of sanction of limits by the SBP.

c) Disbursements by PFIs should not be made to the borrower directly; instead payments shall be made to the manufacturers / suppliers or foreign seller of the machinery through import letter of credit as per payment/delivery schedule agreed to between the manufacturer and the purchaser. Likewise payment for the locally manufactured machinery shall invariably be made through Inland Letter of Credit as per payment/delivery schedule agreed to between the manufacturer and the purchaser.

d) Under the facility, advance payment to the extent of 20% of the C&F value / ex-factory /showroom price can be made in terms of related underlying agreement.

e) Financing to be provided by the PFIs under the proposed Scheme from their own sources (viz 30% of total lending) shall attract rates for end users as defined under the Scheme. However end users will be liable to assume the cost of hedging interest rate risk on the portion of the loan to be provided by the PFI from its own sources.

5. Sanction of Limits and disbursement of Refinance:

a) Refinance under the facility shall be provided by the designated offices of SBP-BSC under the limits sanctioned by the Microfinance Department of State Bank of Pakistan, Karachi in favour of each PFI on yearly basis.

b) Applications for sanction of limits for each fiscal year (July-June basis) shall be sent by the interested PFIs to the Director, Microfinance Department, SBP latest by 15th May each year to facilitate sanction of annual limits at the earliest. For the current year the request for sanction of limits may be submitted within 15 days from the issuance of this circular.

c) State Bank will review the utilization of limits by individual PFI on six monthly basis and may cancel the unutilized limit for reallocation to other PFIs. However, PFIs will have to ensure that they do not sanction and disburse a loan with a view to only utilizing the limit as the credit risk is ultimately assumed by them.

d) After disbursements of the loan under the facility, the PFI can approach the concerned office of SBP-BSC for availing refinance. The office shall provide refinance within two working days from the date of receipt of request on submission of duly filled in prescribed documents i.e. (a) Refinance Application (b) DP Note of the PFI covering the full value of the limit; [to be submitted only once to the office of the SBP-BSC to the extent of the amount sanctioned to each office]; (c) DP Note of the borrower of the PFI duly endorsed in favour of the concerned office of SBP BSC (d) Repayment Agreement; and (e) Undertaking of the borrower on the formats attached to this circular.

e) Failing repayment by PFIs on respective due dates, Offices of SBP-BSC reserve the right to recover the amount of refinance falling due, as per repayment schedule reported at the time of availing refinance, by debit to concerned PFI’s account at SBP-BSC along with any applicable penalties.

f) The PFI shall be under obligation to provide to SBP BSC immediately after sanction of limit by SBP the names of the offices of SBP BSC from where it intends to avail refinance.

6. Risk assessment:

a) Each PFI shall be required to have:

i) Well defined policy and established procedures for appraisal of projects to be financed under the Facility, particularly with regard to their technical and financial viability;

ii) An efficient system for assessing adequacy of machinery items to be financed under the facility, in line with modern business requirements; and

iii) Good internal controls to protect their interest and to fulfill all requirements / conditions of project financing including collateral requirements to mitigate the risk of borrowers' failure to honor their commitments. The policy should have linkages to different business requirements as also to well-defined methodologies for assessing the fitness of prospective borrowers.

b) In case of financing for imported plant and machinery, each PFI shall ensure that the foreign currency risk has been hedged to minimize cost escalation for the project due to adverse exchange rate fluctuations.

c) PFIs shall undertake necessary due diligence process as per their lending policies before sanction of the loan under the facility, which shall invariably be subjected to the applicable Prudential Regulations as prescribed by SBP for each type of borrower. Further, in case of imported machinery, PFIs shall also obtain satisfactory credit reports on suppliers & manufacturers of Plant and Machinery etc. as also required under Chapter XIII of Foreign Exchange Manual (Eighth Edition 2002).

d) PFIs shall consider financing based on the debt to equity requirements as prescribed in applicable Prudential Regulations for each type of the borrower. The financing PFI may, however, ask for higher contribution of equity from the borrowers keeping in view individual risk profile.

e) In case of new projects, sponsor will be required to contribute their equity share in an escrow account maintained with the PFI. The proceeds in the said account shall be used by the sponsors only for the purpose of setting up of the project/payment to the supplier etc; representing his equity share in the project. However, where sponsor(s) of the project have already invested their entire share of equity in the project in the form of land, construction of building etc., the same shall be treated as 'equity' of the sponsor and the condition of maintaining an escrow account may not be required provided overall debt/equity ratio is met. The lending PFI should place a certificate on record in this regard in the relevant credit file for subsequent inspection by our BID.

f) PFIs shall ensure that the working capital facilities in respect of the new project are adequately secured/agreed to, preferably by a financing PFI or one of the member of the consortium, prior to the approval of financing under the facility, so that project does not suffer due to lack of working capital facilities in future.

7. General Terms and Conditions:

a) The cost of insurance, transit insurance, erection and commissioning charges and other incidentals (including transportation charges, in case of locally manufactured machinery) etc; shall not be financed under the facility.

b) PFIs shall reasonably ensure fulfillment of the pre-disbursement formalities by the borrower through due diligence as per their own internal arrangements to avoid misutilization of the Facility through over invoicing, wrong selection of machinery etc.

c) Disbursement under the facility shall be made by PFIs after ensuring that all the pre-disbursement formalities have been completed in accordance with the terms of agreement between the PFI & borrower, and between the supplier / manufacturer and the purchaser / importer of the machinery.

d) There will be no maximum limit for borrowing by the prospective entrepreneurs under this Facility. However, in case of larger financing requirements, i.e. over Rs 300 million, PFIs are encouraged to provide finance under consortium arrangements.

e) In case of consortium financing, the payment to the PFI of the importer / supplier / manufacturer shall be made by the leader of the consortium, who shall therefore, be under obligation to certify the share of each member PFI and the amount disbursed by it, to enable the consortium members to avail refinance from State Bank to the extent of their share subsequent to the actual payment made by the consortium leader. The consortium members may like to make arrangements for sharing of LC commission on the basis of their share in financing, at the time of finalization of the consortium agreement. The commission shall, however, be charged on the basis of rates published by the LC opening bank in its schedule of charges. The LC shall normally be opened by the leader of the consortium if not otherwise agreed mutually by the consortium.

f) PFIs shall make necessary arrangements to ensure that the amount of refinance availed by them from State Bank and outstanding as on the date of preparation of their financial statements is shown separately in Annual Audited Accounts, under appropriate heads, vis-à-vis their claims (principal amounts only) against their constituent to whom the financial facilities were sanctioned by them.

g) State Bank shall have the right to appoint an independent consultant to verify the use of the refinance under the Facility for the purposes spelt out under the Facility. In case the report of the consultant points out irregularity on the part of the financing PFI or the borrower, State Bank reserves the right to recover the amount of refinance granted to the PFI alongwith fine at the prescribed rate including the cost of such verification. As the PFIs are expected to fulfill the conditions prescribed by SBP under the Facility, fine so recovered shall be absorbed by them. In case, they pass on the fine so recovered to the borrower, the PFI shall be under obligation to justify the same and would not pass it on to the borrower merely on the strength of the action of State Bank of Pakistan.

h) In case of the import of plant and machinery, the foreign currency required for making payment to the machinery manufacturer or the suppliers abroad, against LC, shall be purchased by the PFI of the borrower from the inter-bank market at prevailing rates. In case the machinery is to be imported under usance LC, both the exporter and its PFI (s) would ensure that they have made necessary arrangements to hedge their position against adverse exchange rate movements. The quantum of the loan amount in equivalent Pak rupees shall be determined on the basis of the rupees resources required for purchase of the foreign currency on the actual date of retirement of LC and shall be released in accordance with the payment terms.

i) PFIs should ensure adequate training arrangements for the staff/officials handling cases under the facility with a view to ensure compliance with internal rules / regulations / procedures and those prescribed by SBP.

j) All LCs (sight as also usance) established after announcement of the scheme shall be eligible for financing.

k) In case the projections made by the borrowers in respect of export sales are not met with a confidence interval of 10% the State Bank would consider to impose a fine on the borrower at a rate to be determined by the State Bank provided the borrowers fail to provide justification for the same. PFIs would be under obligation to keep track of borrower's performance in this regard and submit the position to the inspection teams of the Banking Inspection Department of the State Bank at the time of inspection of the PFI, if so desired

8. Fines for Default:

(i) Under the facility fine for any irregularity shall be imposed on the borrower or the PFI as the case may be, depending upon the nature of irregularity. In all cases it shall be recovered through the PFI who availed refinance. It will be the responsibility of the PFI to secure its interest in this regard, however, in no case fine imposed on PFI due to its negligence shall be passed on to the borrower. In case, they pass on the fine so recovered from them to the borrower, the PFI shall be under obligation to justify the same to ensure that the fine is not passed on to the borrower merely on the strength of the action of the State Bank of Pakistan.

(ii) Fine shall be recovered at the following rates:-

a. In case of violation of the terms & conditions laid down in the Facility the State Bank shall reserve the right to recover the amount of refinance granted to the PFI alongwith fine at the rate of paisa 60 per day per Rs 1000/- or part thereof including the cost of such verification. PFIs failure to repay refinance under the facility on account of prepayments by the borrower shall also attract fine at the same rate.

b. Where the borrowers of PFIs repay their obligations in part or in full, whether premature or on due date(s), the PFIs shall adjust the loan amount on prorata basis keeping in view the share of financing made by them through their own sources and refinance availed from SBP. They shall repay the SBP's portion of loan amount so received from the borrower immediately, but not later than two working days, to the concerned office of SBP-BSC, failing which fine for late adjustment of amount will be charged from the PFI at the rate of paisa 70 per day per Rs 1,000 or part thereof. The PFI would ensure that at no point of time, outstanding amount (principal) repayable to them by their borrower and appearing in its books of accounts falls below the outstanding amount of refinance, which they owe to State Bank of Pakistan.

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Schedule-1

Long Term Financing Facility (LTFF) for Plant & Machinery-
Sectors eligible for financing under the Facility

Only new plant, machinery & equipments to be used by the export oriented projects in following sectors for producing exportable goods shall be eligible for financing under the Facility:-

Core Categories

1. Textile & Garments
    a. Fabrics
    b. Garments
    c. Made up
    d. Towels
    e. Art silk & synthetic textiles
2. Rice Processing
3. Leather & Leather products
4. Sports goods
5. Carpets & Wools
6. Surgical Instruments

Developmental Categories

1. Fisheries
   (Plant & machinery used for boat manufacturing / modifications including chilling equipment).
2. Poultry & Meat
   (Plant & machinery used for hatching purposes and equipments for preservation / packing / canning chicken & meat)
3. Fruits/Vegetable & Processing, Cereals.
   (Plant & machinery used for setting up of units for the purpose of preservations/ packaging / canning of fruits and vegetables and producing cereals).
4. I.T. – Software & Services
   (Hardware & equipments for IT & Services sector exports)
5. Marble & Granite
   (Plant & equipments used for cutting and polishing of Marble & Granite products for export and manufacturing of handicrafts thereof)
6. Gems & Jewellery.
   (Plant & equipments used for cutting and polishing of Gems and machinery for making jewellery)
7. Engineering goods
   (Plant & machinery required for producing engineering products / goods)

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