PRUDENTIAL REGULATIONS FOR MICROFINANCE BANKS (MFBs)

Updated on May 16, 2025

AGRICULTURE CREDIT & FINANCIAL INCLUSION DEPARTMENT

STATE BANK OF PAKISTAN

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TABLE OF CONTENTS

Preface

Cognizant of peculiar dynamics and evolution of microfinance sector, State Bank of Pakistan (SBP) maintains a 'proportional' regulatory approach to promote innovation and stability. The underlying principle has always been to keep balance between inclusion and prudence.

In view of business growth and technological innovations in the sector, SBP has further strengthened the regulations in areas of governance, consumer protection, and operations to help Microfinance Banks (MFBs) to manage the expected higher level of growth in future. To add clarity, the Prudential Regulations (PRs) for Microfinance Banks have been segregated in three categories viz. Risk Management (R), Corporate Governance (G), and Operations (O).

These Prudential Regulations do not supersede other directives issued by the SBP in respect of areas not covered here. Any violation or circumvention of Microfinance Institutions Ordinance 2001 and SBP regulations/directives for MFBs may render the concerned MFB and/or its concerned officer(s) liable for enforcement action by the SBP.

Further, SBP will continue to oversee the sector-related developments with strategic perspective. For this purpose, SBP will remain open to review any of the existing regulations, while enacting new regulations where prudence warrants.

Definitions

a. **Agricultural and Livestock Financing** means:

(i) Farm Credit, which includes:

(a) Production Loans for inputs like seeds, fertilizers, pesticides, etc.
(b) Farm Development Finance for improvement of agricultural land, orchards and construction of Godowns, etc.
(c) Finance for the purchase of agricultural machinery and equipment like tractors, threshers, etc. and

(ii) Non-farm credit, which includes financing for fisheries and Livestock viz. dairy, poultry etc.

For the purpose of these regulations, Agriculture financing shall not include loans to traders and intermediaries engaged in trading/processing of agricultural commodities which shall be covered under microenterprise lending.

b. **"Government Approved securities"** shall include such types of Pak. Rupee obligations of the Federal Government or 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 Approved Securities.

c. **"Branchless Banking"** or **"BB"** means conduct of banking activities by authorized financial institutions for customers having a branchless banking account.

d. **"Contingent liabilities"** means 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/person; or 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.

e. **"Deposit"** means the deposit of money, repayable on demand or otherwise, accepted by an MFB from the public for the purpose of providing microfinance services.

f. **"Documents"** include vouchers, bills, promissory notes, bills of exchange, securities for advances, claims by or against microfinance bank and other record supporting entries in the books of the MFB.

g. **"Equity"** includes paid-up capital in respect of ordinary shares, general reserves, balance in share premium account, reserve for issue of bonus shares, statutory reserves, and retained earnings/accumulated losses as disclosed in latest annual audited financial statements.

h. **"Exposure"** means

a) Financing Facilities whether fund based or non-fund based extended by an MFB and include: i) Any form of financing facility extended or Bills purchased/discounted, Bills purchased / discounted on the guarantee of the person. ii) Credit facilities extended through Corporate Cards. iii) Financial guarantees issued on behalf of the person. iv) Any obligations undertaken on behalf of the person under any other guarantees including underwriting commitments. v) Any other liability assumed on behalf of the person to advance funds pursuant to a contractual commitment.
b) Subscription to or investment in shares, Participation Term Certificates, Term Finance Certificates, Sukuk or any other Commercial Paper by whatever name called issued or guaranteed by the persons.

i. **"Family member"** of a person means his/her spouse, dependent lineal ascendants and descendants and dependent brothers and sisters.

j. **"Housing Finance"** means financing provided to individuals for the construction, purchase of residential house/apartment and for purchase of plot and construction thereupon. Financing availed for the purpose of making improvements in house/apartment shall also fall under this category.

k. **“Director”** means any natural person occupying the position of a director on the board of a MFB and includes non-executive (independent/nominee/sponsor)**,** executive and alternate director, as defined below:

   i. **“Alternate Director”** means a person who has been appointed by a director during his/her absence, as per provisions of the Section 174 of Companies Act 2017.

   ii. **“Executive Director”** means a paid employee or executive in the concerned MFB who is also a member of the board of directors of the MFB.

   iii. **“Non-executive Director”** means a director who is not entrusted with responsibilities of an administrative or managerial nature; and includes independent director and nominee director as given below:

      a. **“Independent Director”** means a non-executive director who qualifies the Criteria for Independent Director as defined in section 166 of the Companies Act 2017, provided that the term ‘major shareholder’ used in section 166 of *ibid* shall be replaced with the term ‘sponsor shareholder’ as defined in “Prudential Regulations for MFBs”.

      b. **“Nominee Director”** means a non-executive director nominated on the board ofan MFB by the sponsors, persons, company, institutions, creditors, etc. by virtue of shareholding and/or interest in the MFB.

      c. **“Sponsor Director**” means the member of the Board of Directors of a MFB holding sponsor shares.

l. **“Key Executive”** includes the officials responsible for overseeing following functional responsibilities:

   i) Any executive, acting as second to CEO including Chief Operating Officer, Chief Financial Officer, Deputy Managing Director or by whatever name called, the Company Secretary, Shariah Advisor and heads of the following departments;
   ii) Finance/ Accounts;
   iii) Internal Audit;
   iv) Risk Management;
   v) Compliance;
   vi) Credit;
   vii) Operations;
   viii) Digital Financial Services/Branchless Banking
   ix) Human Resource;
   x) Information Technology;
   xi) Islamic Banking
   xii) Any other official with direct reporting lines to the President/CEO/Managing Director.

   The condition for hiring all key executives will become mandatory whenever deposit base or gross loan portfolio of an MFB exceeds Rs. 3 billion, or the MFB completes three years in operations, whichever is earlier. Further, if a person is overseeing more than one key functional areas, it shall be ensured that there is no conflict of interest in such arrangements. The same shall also be notified to SBP by the concerned MFB.

m. **Liquid Assets** means 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 SBP, listed TFCs rated at least 'A' by a credit rating agency on the approved panel of SBP 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 MFBs with perfected lien.

n. **“Microfinance Bank - MFB”** means a company incorporated in Pakistan and licensed by the SBP under Microfinance Institutions Ordinance, 2001 as a microfinance bank for the purpose of providing microfinance services, especially mobilizing deposits from the public and providing credit to poor persons and micro-enterprises.

o. **“Microenterprises”** means small projects or businesses in trading, manufacturing, services, etc. that lead to livelihood improvement and income generation. Moreover, these projects/businesses are undertaken by individual micro entrepreneurs who are either self-employed or employ few individuals not exceeding 25 (excluding seasonal labor).

Microenterprises may include business and/or livelihood activities such as small software houses, carpentry, electrical works, food stalls, lathe machine workshops, small manufacturing units etc; which have traditionally lacked access to formal financial services.

p. **“Mortgage**” means transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan or finance.

q. “**Group Based Lending”** means a single loan made to multiple clients, for which they share repayment responsibility primarily through personal guarantees.

r. **“Poor Person”** means an individual who has meager means of subsistence but is involved in a livelihood activity and has an ability to repay debt from an annual income (net of business expenses) up to Rs. 1,500,000/-.

s. **Records”** include ledgers, day books, cash books, books of accounts, and all other books, maintained either on paper books or in digital form or on electronic or magnetic devices, used in the business of a microfinance bank;

t. **“Restructuring”** means such concessions to the borrower, due to borrowers’ financial difficulty, which the MFB would not otherwise consider. Restructuring normally involves modification in the terms & conditions of the financing / securities and generally includes, amongst others, alteration of repayment period, repayable amount, installment amount mark-up rates (due to reasons other than competitive pricing) etc.

u. **“Rescheduling”** means such concession in the grace period or modification in the repayment dates of principal loan amount (without changing overall loan tenor), due to borrowers’ financial difficulty, which the MFB would not otherwise consider.

For rescheduling and restructuring, MFBs shall define the term ‘financial difficulty and its indicators’ in their board approved credit / risk management policies based on financial ratios and indicators, days past due, nature of facility and borrowers credit worthiness, borrowers’ industry, etc.

v. **“Secured”** means exposure backed by liquid assets, pledge stock - including pledging against Electronic Warehouse Receipt (EWR) as defined in Collateral Management Companies Regulations, 2019 issued by the SECP, mortgage of land, building or any other fixed assets, hypothecation of plant, machinery, stock (inventory), trust receipt, assignment of receivable, lease rentals, and contact receivables but does not include hypothecation of household goods. The unsecured exposure will be considered as clean/unsecured.

Mortgage of land created by way of bank's charge on passbook and registration of charge in the books of the revenue authority would also be considered secured for the purpose of these regulations.

w. **“Sponsor Shares”** means 5% or more paid-up shares of an MFB, acquired by a person individually or in concert with his/her family members, group companies, subsidiaries, and affiliates/associates. Such acquisition of shareholding will include all the shares acquired by aforesaid person(s) including, inter alia, through (a) as original subscriber / promoter of an MFB; (b) subsequent right / bonus issues; (c) market based acquisition deal; (d) reconstruction/restructuring of an MFB carried out by SBP; (e) amalgamation of MFBs; or (f) any other mode of acquisition. All shares acquired by common shareholders, who are also sponsor shareholders, of amalgamating MFBs in amalgamation transaction shall be considered Sponsor Shares.

Explanation: For the purpose of sponsor shares, family members include his spouse, lineal ascendants and descendants and dependent brothers and sisters.

x. **“Sponsor Shareholders”** mean all those shareholders of a MFB holding sponsor shares.

y. **“SBP”** means State Bank of Pakistan established under The SBP Act, 1956.

z. **“Substantial/Controlling interest”** in an undertaking shall be deemed to be possessed by a person if he or any of his family members is the owner, director or officer of or has control over the undertaking or if he or any of his family members holds shares carrying not less than twenty per cent of the voting power in such undertaking.

aa. **“Ultimate Beneficial Owner”** shall have the same meaning as defined in the Companies Act 2017 i.e. the natural person who ultimately owns or controls a company, whether directly or indirectly, through such percentage of shares or voting rights or by exercising effective control in that company through such other means, as may be specified.

RISK MANAGEMENT (R)

Regulation R – 1: Minimum Capital Requirements

Microfinance Banks (MFBs) are required to comply with the following two capital standards:

i. Minimum Capital Requirement (MCR):

Microfinance Banks (MFBs) shall maintain a minimum paid up capital (net of losses) of at least Rs. 2 billion. The existing MFBs (irrespective of their category) shall raise their minimum paid-up capital to at least Rs. 2 billion in a phased manner, given as under:

Category	Minimum Paid up capital (free of losses) required as of		
	Existing	**30-June-2026**	**30-June-2027**
MFB (Provincial)	Rs. 500 million	Rs. 1.5 billion	Rs. 2 billion
MFB (National)	Rs. 1 billion	Rs. 1.5 billon	Rs. 2 billion

The MCR standard includes the following items:

a) Fully Paid-up Common Shares
b) Balance in Share Premium Account
c) Reserve for issue of Bonus Shares
d) Any other type of instrument approved by the SBP

Less

e) Accumulated losses/ Discount allowed on the issuance of shares
f) Negative General Reserves

ii. Capital Adequacy Ratio (CAR):

MFBs shall also maintain Capital Adequacy Ratio (CAR) equivalent to at least 15% of their risk weighted assets. The CAR is calculated by taking the Eligible Regulatory Capital as numerator and the Total Risk Weighted Assets (T-RWA) as denominator.

$$CAR = \frac{Total\ Eligible\ Capital}{Total\ Risk\ Weighted\ Assets}$$

Instructions on calculation of CAR are given in Annexure - A.

Regulation R – 2: Exposure against Contingent Liabilities

The contingent liabilities of an MFB for the first three years of its operations shall not exceed three times of its equity and thereafter shall not exceed 5 times of its equity.

Regulation R – 3: Maintenance of Cash Reserve and Liquidity

A. Cash Reserve Requirement (CRR):

1. **Maintenance of CRR:**
   Microfinance Banks (MFBs) shall maintain CRR in the form of balances in their current accounts maintained with SBP.

2. **Reserve Maintenance Period:**
   The reserve maintenance period shall be of two weeks starting from Friday and ending on Thursday of the subsequent week.

3. **CRR Rate:**
   a) During the reserve maintenance period, Cash Reserves shall be maintained at an average of 3% of total of 'demand liabilities' and 'time deposits with tenor of less than 1 year' subject to a daily minimum requirement of 2%.

   b) Time Liabilities, excluding time deposits with tenor of less than one year, are exempted from maintenance of cash reserves.

   c) Tenor means original fixed term of the time deposit at the time of booking and does not indicate remaining maturity period.

4. **Applicable Liabilities for determination of CRR:**

   a) The Liabilities which are subject to CRR and liabilities that are exempted from maintenance of CRR are given in Annexure-B.

   b) Liabilities as of close of business on Friday (first day of reserve maintenance period) will be taken into account for determination of required CRR. If Friday is a holiday, then Liabilities as of close of business on preceding working day will be taken into account.

5. **Maintenance of CRR on Premature Withdrawal of Time Deposits:**
   If Time Deposits having tenor of one year and above are withdrawn prematurely before completion of one year, the MFB is required to maintain an additional CRR at the rate equivalent to the difference (if any) between CRR applicable on Time Deposits with tenor of less than one year (i.e. currently 3%) and Time Deposits with tenor of one year and above (i.e. currently zero). The additional CRR will be applicable on the amount of such premature withdrawal and for the period for which an MFB availed the benefit of lower CRR.

6. **Penalty on default in maintaining CRR:**
   a) For levy of penalty on default in maintaining average balance, the minimum balance required to be maintained during the reserve maintenance period shall be the product of CRR Rate (Average i.e. currently 3%), Liabilities (subject to CRR) and number of days in the reserve maintenance period.

   b) Minimum balance required to be maintained, as calculated above, will be compared with the aggregate of the balances maintained during the reserve maintenance period with SBP. If the aggregate balance maintained, during the reserve maintenance period, is below the minimum balance required to be maintained, the bank shall render itself liable to pay the penalty. The penalty shall be levied on the shortfall between the aggregate balance maintained and the aggregate minimum balance required to be maintained during the reserve maintenance period.

   c) If any MFB maintains the required average balance (currently 3%) during the reserve maintenance period but fails to maintain a daily minimum balance (currently 2%) at the close of business on any day, such bank shall also render itself liable to pay the penalty.

   d) While calculating the CRR, the balances maintained as per books of SBP shall be taken into account.

   e) In case of shortfall in maintenance of CRR, the concerned MFB shall be liable to pay penalty @ one percent of the shortfall per day which shall be calculated on the basis of reporting through Reporting Chart of Accounts and/or return as required by SBP.

B. Statutory Liquidity Requirement (SLR):

1. **Rate of SLR:**
   a) MFBs are required to maintain the liquid assets (excluding CRR) equivalent to at least 12% of their total ‘demand liabilities’ and ‘time deposits with tenor of less than one year’ in Pakistan.
   b) Time Liabilities (excluding time deposits with tenor of less than one year) are not subject to any SLR.
   c) Tenor means original fixed term of the time deposits at the time of booking and does not indicate remaining maturity period of the time deposits.

2. **Eligible Liabilities for determination of SLR:**
   a) The Liabilities which are subject to SLR and exempted from maintenance of SLR have been defined in Annexure-B-1.
   b) For maintaining SLR, during the fortnight starting from Friday and ending on Thursday of the subsequent week, Liabilities subject to SLR as of close of business on Friday (first day of the fortnight) will be taken into account for determination of required SLR. If Friday (first day of fortnight) is a holiday, then Liabilities (subject to SLR) as of close of business on preceding working day will be taken into account.

3. **Eligible Liquid Assets for maintenance of SLR:**
   The Liquid Assets eligible for SLR maintenance shall be as under:
   a) Cash
   b) Balances with SBP (In Current A/C)
   c) Balance with National Bank of Pakistan (NBP)
   d) Unencumbered approved securities including Treasury Bills, Pakistan Investment Bonds, Government of Pakistan Ijara Sukuk, or any other security declared by SBP as eligible for SLR from time to time.
   e) MFB shall, however, not account for the unencumbered approved securities held under depositor protection fund for the purpose of calculating statutory liquidity reserve.

4. **Maintenance of SLR on Premature withdrawal of Time Deposits:**

   If Time Deposits having tenor of one year and above are withdrawn prematurely before completion of one year, the MFB is required to maintain additional SLR at the rate equivalent to the difference (if any) between SLR applicable on Time Deposits with tenor of less than one year and Time Deposits with tenor of one year and above. The additional SLR will be applicable on the amount of such withdrawal and for the period for which bank availed the benefit of lower SLR.

5. **Monitoring of SLR:**
   “Balances (of banks) with SBP” are part of liquid assets, therefore, SBP monitors maintenance of liquid assets requirement by adding SLR and CRR. For instance, currently SLR is 12% whereas CRR is 3%. Accordingly, SBP will monitor liquid asset requirement @ 15%.

6. **Penalties:**
   In case of shortfall in maintenance of SLR, the concerned MFB shall be liable to pay penalty @ one percent of the shortfall per day which shall be calculated on the basis of reporting through Reporting Chart of Accounts and/or return as required by SBP.

<u>Regulation R – 4:</u> Statutory Reserve

The MFB shall create a reserve fund which shall be credited with:

i. An amount equal to at least 20% of its annual profits after taxes till such time the reserve fund equals the paid-up capital of the MFB.
ii. Thereafter, a sum not less than 5% of its annual profit after taxes.

<u>Regulation R – 5:</u> Maximum Loan Size and Eligibility of Borrowers

Microfinance Banks should ensure that the loans have been utilized for the same purposes for which they were obtained. For this purpose, the MFBs may consider it prudent to make payments directly to the suppliers wherever appropriate.

Maximum loan sizes and borrowers' income eligibility criteria shall be as under;

A) Agriculture & Livestock Loans:

The maximum size for Agriculture & Livestock loans shall be up to Rs. 5,000,000/- to a single borrower.

While extending agricultural & livestock financing, the MFBs should take into account the total indebtedness of the borrower and his disposable income. The MFBs should ensure that the total financing to a borrower, in relation to his repayment capacity, does not exceed the reasonable limits as laid down in approved credit policy of the MFB.

Wherever necessary, the MFBs shall link repayment of loans to the nature of loans disbursed and repayment capacity of borrowers. For example, in case of Farm credit, such loans are self-liquidating at the end of the growing cycle from the proceeds of the product sale, therefore, the maturities of these loans shall coincide with the production cycle for the product being financed. The tenure of this sort of financing will generally be less than one year. However, for certain crops requiring longer periods (from sowing to sale of the produce), MFBs at their own discretion may extend financing for periods longer than one year.

B) Housing Loans:

The maximum size for Housing loans shall be up to Rs. 5,000,000/- to a single borrower with annual income (net of business expenses) up to Rs. 1,500,000/-.

Further, MFBs shall ensure to implement the following requirements:

i. **General Instructions**

a) MFBs shall not allow housing finance purely for the purchase of land/plots; instead, such financing would be extended for the purchase of land/plot, construction and renovation of house.

b) The sanctioned financing limit, assessed on the basis of repayment capacity of the borrower, value of land/plot and cost of construction on it etc. shall be disbursed in tranches.

c) The amount disbursed for purchase of plot must not exceed the 90% of the market value/cost of land/plot and 50% of the financing limit. The remaining amount shall be disbursed for construction there-upon.

d) MFBs will take a realistic construction schedule from the borrowers before allowing initial disbursement. For construction-only cases, the sanctioned financing shall also be released in tranches commensurate with the stage of construction.

e) In case of cost overrun, MFBs may entertain the customer for additional finance for completion of house, keeping in view the Debt Burden Ratio (DBR) and cushion in overall Loan-to-Value (LTV) ratio.

ii. **Permission from Relevant Authorities**
The MFBs shall not disburse housing finance unless ensured that prior permissions/clearances for construction / purchase of property from relevant authorities are available.

iii. **Creation of Mortgage**
The plot/house/flat financed by the MFBs shall be mortgaged in MFBs' favour by way of equitable or registered mortgage.

iv. **Loan to Value (LTV) Ratio**
Loan to Value Ratio should not exceed 90%.

v. **Risk Management and Internal Control Systems**
Risk management framework, duly approved by the Board of Directors of MFBs, should appropriately cover housing finance. MFBs shall ensure strict compliance with their internal policies and procedures and those prescribed by SBP from time to time.

vi. **Information Disclosure**
MFBs shall clearly disclose all the important terms & conditions, fees, charges and penalties etc., which should, inter-alia, include annualized percentage rate, pre-payment penalties and the conditions under which they apply. For the purpose of this regulation, Annualized Percentage Rate means as follows:

Mark-up for the period	X	365	X	100
Average outstanding principal amount during the period		No. of days		

vii. **Development of Financing Documentation**
The MFBs shall prepare standardized set of financing and recourse documents, duly cleared by their legal counsels, comprising of financing agreement, application form and the other requisite supplementary documents.

viii. **Title Documents**
MFBs shall obtain all title and ownership related property documents from customers which should be clear and free from all encumbrances/legal charges and get these documents vetted by their legal department/advisor(s). MFBs shall provide a signed copy of the list of all title and property documents to the borrowers.

ix. **Verification of Property-related Documents**
MFBs shall verify necessary information provided in the application form. Accordingly, all title and other legal documents provided with application form shall be verified directly from the relevant issuing authorities. All the documents shall be kept in safe custody meeting all procedures/ requirements.

x. **Property Assessment**
MFBs shall ensure that a proper property valuation is done by their internal resources. However, properties valuing above Rs. 5.0 million shall be subject to assessment by valuator approved on the panel of Pakistan Banks' Association.

xi. **Insurance/Takaful**
MFBs may obtain insurance/takaful coverage of the housing unit financed through a reputable insurance/ takaful company to sufficiently cover their risk.

xii. **Monitoring of Market Conditions**
The management of MFBs shall put in place a mechanism to monitor conditions in housing finance market at least on half-yearly basis to ensure that their policies are aligned with the current market conditions.

C) Microenterprise Loans:
The maximum size for microenterprise loans shall be up to Rs. 5,000,000/- to a single project or business. The MFBs shall extend the microenterprise loans only in the name of micro entrepreneurs to ensure traceability and reduce the incidence of multiple borrowing.

Pre-requisites for Undertaking Microenterprise Lending:

i. MFBs interested to extend microenterprise loans shall develop related institutional capacity (products manuals, credit risk management and monitoring system, system and controls, trainings etc.)

ii. While extending microenterprise loans, MFB shall itself evaluate its preparedness, including its operational/financial performance, funding plan, supervisory assessment and credit rating to establish its preparedness and capacity to extend these loans.

iii. MFBs shall have in place a board approved Microenterprise lending policy that shall at minimum outline the objectives, targets, business model, credit scoring system, pricing, income assessment methodology, IT infrastructure & cyber security, consumer protection & awareness measures including data privacy and protection etc.

D. General Loans:

The maximum size for General loans other than Agriculture & Livestock, Housing and Microenterprise loans shall not exceed Rs. 500,000/- to a poor person with annual income (net of business expenses) up to Rs. 1,500,000/-. These shall include general purpose loans like loans for installation of solar panels, laptop loans for students and freelancers, vehicle/motorbike loans for livelihood activities etc. Further, MFBs may also issue local credit cards/running finance facility for livelihood purposes only (example: (i) fuel cards for goods delivery riders (ii) running finance for retailers/traders etc.).

Miscellaneous Instructions:

(a) Income Eligibility Assessment:
While assessing income eligibility on individual borrowers (including salaried persons), MFBs shall ensure that the total installment of the financing facilities extended by the financial institutions is commensurate with monthly income and repayment capacity of the borrowers, such that total monthly amortization payments of financing facilities should not exceed 50% of the net disposable income of the prospective borrowers. These measures would be in addition to MFBs' usual evaluations of each proposal concerning credit worthiness of the borrowers, to ensure that their portfolio fulfills the prudential norms, instructions issued by the SBP and does not impair the soundness and safety of the MFB itself.

(b) Financing against the Security of Gold:
MFBs shall also develop a collateral handling policy duly approved by their Board of Directors to manage security, procedures, and contingency planning for the gold collateral. While formulating policy on gold collateral handling, MFBs shall take into account prescribed minimum instructions given in Annexure–H.

However, MFBs shall ensure that the aggregate loan exposure against the security of gold shall not exceed 35% of their gross loan portfolio.

(c) Information Disclosure
For all type of loans (Agriculture, Housing, Microenterprise and General), the MFBs shall clearly disclose all the important terms & conditions, fees, charges and penalties etc., which should, inter-alia, include annualized percentage rate, pre-payment penalties and the conditions under which they apply. For the purpose of this regulation, Annualized Percentage Rate means as follows:

Mark-up for the period	**X**	**365**	**x**	**100**
Average outstanding principal amount during the period		**No. of days**		

<u>Regulation R-6:</u> Maximum Exposure of a Borrower from other Financial Institutions

The maximum limits of the borrowers' aggregate exposure shall not exceed Rs. 5,000,000/- for Agriculture & Livestock, housing and microenterprise loans; and Rs. 500,000/- for general loans. However, the aggregate exposure of the borrowers who are eligible to avail all type of microfinance loans shall not exceed Rs. 5,000,000/-.

The MFBs shall develop an internal mechanism to monitor the overall exposure of their borrowers to manage credit risk and minimize the risk of borrowers' over-indebtedness. At the time of granting facility, MFBs shall ensure that total exposure of their clients does not exceed their total repayment capacity as determined under the criteria laid-out in the MFBs' credit policy.

Regulation R-7: Credit Report Check

Before allowing any credit facility, the MFBs shall obtain Credit Information Report (CIR) from the licensed Credit Bureaus of which they are a member or from electronic Credit Information Bureau (eCIB) of SBP. However, the requirement for obtaining CIR shall not be applicable in the case of loans having value below Rs. 25000/-

MFBs shall assign due weightage to the CIRs in addition to their risk management policies and approved criteria while undertaking credit appraisals of the prospective borrowers. Credit applications, however, may not be turned down solely on the basis of overdue amount reported in the CIRs.

MFBs shall also obtain CIR before Rescheduling /Restructuring of any loan. MFBs shall record details of overdue loans from CIRs in their system. Also, MFBs shall duly record any exception while granting approval of loan in the systems and make such information available to SBP for onsite/offsite assessment of loan portfolios**.**

The MFBs shall also ensure that CIR is not older than one month at the time of sanctioning credit limits.

<u>Regulation R – 8:</u> Classification of Assets and Provisioning Requirements

A. Specific Provisioning: The outstanding principal and mark-up of the loans and advances, payments against which are overdue, shall be classified as Non- Performing Loans (NPLs) as prescribed below:

Loan Categories	Time based Criteria for Classification of Assets and Provisioning Requirements
Agriculture and Livestock Loans	Annexure I-1 & I-4
Housing Loans	Annexure I-2
Microenterprise Loans	Annexure I-3 & I-4
General Loans	Annexure I-5

B. General Instructions for Classification / Provisioning of all loan categories:

(a) Watch list

MFBs shall maintain a watch list of all overdue accounts before they are classified in terms of objective (time-based) criteria. However, such accounts may not be treated as NPLs for the purpose of classification / provisioning.

(b) Government Guaranteed Loans

Classified loans/ advances that have been guaranteed by the Government would not require provisioning to the extent of guaranteed portion. However, markup/ interest on such loans shall not be taken into the income account, rather, the same would be parked in a Memorandum Account.

(c) Subjective Classification

i. In addition to the time-based criteria prescribed in this regulation, subjective evaluation of performing and non-performing credit portfolio may be made for risk assessment purposes and, where necessary, any account including the performing account may be classified. In this case, the category of classification determined on the basis of time based criteria can be further downgraded.

ii. Classification for group based lending shall be based on objective (time-based) criteria only, though MFBs, at their own discretion, may also classify such portfolio on subjective basis.

iii. To strengthen subjective classification, MFBs may consider financial standing of guarantors.

(d) Reversal of Specific Provisions
In case of cash recovery against classified assets, other than rescheduling / restructuring under R-9 of PRs for MFBs, MFBs may reverse/adjust specific provisioning held against classified assets.

(e) Adjustment Lending:

MFBs are prohibited to undertake any sort of adjustment lending (adjusting the existing loan with a fresh loan) to avoid classification. However, in case of running finance, where the outstanding mark-up has been received by the MFBs, the principal amount may be rolled over/renewed and this rollover/renewal shall not be considered adjustment lending for the purpose of this regulation. Moreover, MFBs are required to implement a clean-up or cooling-off period, preferably 2 to 3 days, before disbursing a new loan. This is intended to discourage practices where new loans are issued with enhanced limits primarily to cover the repayment of principal and mark-up on existing loans.

(f) Quarterly Review
MFBs 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, shall be provided for immediately.

(g) Benefit of Forced Sale Value:
MFBs can avail the benefit of Forced Sale Value (FSV) of collateral held against loans / advances subject to the following:

i. The benefit of FSV shall not be available for the payment of cash or stock dividend.
ii. The heads of Credit and Risk of respective MFB shall ensure that FSV used for taking benefit of provisioning is determined accurately and is reflective of market conditions under forced sale situations.
iii. Borrower-wise details of such cases shall be maintained for verification by SBP. In case of misuse of this facility, SBP may instruct the concerned MFB for withdrawal of the benefit of FSV.

(h) Responsibility of the External Auditors
The external auditors shall, as part of their annual audits of MFBs, verify that all requirements, as stipulated in this regulation, for classification and provisioning have been complied with.

***Note:** As per para 3.5 of IFRS-9' instructions issued vide 'BPRD Circular No. 03 of 2022', a two-track approach analogous to the present regulations is to be followed. Annexure C of 'BPRD Circular No. 03 of 2022' and subsequent instructions issued from time to time may be referred in this regard.

Regulation R – 9: Rescheduling/Restructuring of Loans

MFBs may reschedule/restructure their loans (both regular as well as non-performing) as per the terms and conditions mentioned below. However, such rescheduling/restructuring should not be merely to avoid classification:

a) MFBs should have in place a Rescheduling/Restructuring Policy duly approved by their Board of Directors (BOD).

b) The rescheduling/restructuring of non-performing loans/finances shall not change the status of classification of a loan/advance etc. unless 10% of the outstanding loan amount (principal+ mark-up) is recovered in cash and the terms and conditions of rescheduled/restructured loans are fully met for at least 1 year excluding grace period (if any) from the date of such rescheduling/restructuring. However, the condition of at least 1-year retention period, prescribed for restructured/rescheduled loans to remain in the classified category, will not apply in case the borrower has repaid or adjusted in cash at least 35% of the total rescheduled/restructured loan amount (principal + mark-up), either at the time of rescheduling/restructuring agreement or later-on during the grace period, if any.

c) 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. While reporting to the Credit Information Bureaus (CIBs), these loans/advances/finances may be shown as 'rescheduled/restructured' instead of 'overdue/default'.

d) Where a borrower subsequently defaults (either on principal or mark-up) after the rescheduled/ restructured loan has been declassified by the MFB as per above guidelines, the loan will again be classified in the same category from the date of default as 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, MFBs at their discretion may further downgrade the classification, taking into account the subjective criteria.

e) All fresh loans granted by an MFB to a borrower after rescheduling/ restructuring of its existing facilities may be monitored separately, and shall be subject to classification as per their own specific terms and conditions.

Regulation R-10: Charging-off Non-Performing Loans (NPLs)

The intent of 'charge-off' is to clear the balance sheet of MFBs, and this shall in no way extinguish the MFBs' right of recovery of such loans. NPLs shall be charged off as prescribed below:

Loan Categories	Criteria for Charging Off NPLs
Agriculture & Livestock Loans	NPLs secured against Mortgaged residential, commercial and industrial properties (Land & building only) shall be charged off, one month after 05 years from the date of classification. All other NPLs shall be charged off, one month after 03 years from the date of classification.
Housing Loans	NPLs shall be charged off, one month after 05 years from the date of classification of financing.
Microenterprise Loans	NPLs secured against Mortgaged residential, commercial and industrial properties (Land & building only) shall be charged off, one month after 05 years from the date of classification. All other NPLs shall be charged off, one month after 03 years from the date of classification.
General Loans	NPLs shall be charged off, one month after being classified as "Loss."

Note: Charge-off means reducing the value of the loans in 'loss' category to zero through offsetting the provisions, thus, removing such loans from the balance sheet.

Regulation R – 11: Investments of Funds

MFBs may invest their surplus funds in Government Securities like Treasury Bills, Pakistan Investment Bonds and GoP Ijara Sukuk Bonds etc., 'A' rated debt securities like TFCs and units of those mutual funds which maintain their investment portfolio in fixed income securities or money market instruments.

In addition, MFBs may acquire or hold shares of any corporate body, the objective of which is to provide microfinance services, technical, vocational, educational, business development and allied services to the poor and micro enterprises.

The maximum investment in such a company shall not exceed 10% of paid-up share capital of that company or 5% of MFBs' own equity free of losses, whichever is less. The aggregate investments in such corporate bodies shall not exceed 10% of MFBs' equity, free of losses.

The MFBs shall have an approved policy incorporating therein an internal evaluation process for an objective analysis and assessment of their equity investment decisions, which must consider factors including, inter alia, financial standing of the MFB, aggregate investment portfolio, risk appetite and expected return, level of expertise, business strategy including exit strategy etc.

Regulation R – 12: Payment of Dividends

MFBs shall not pay any dividends on their shares until:

a) They meet the MCR and CAR as laid down by the SBP from time to time;

b) All the provisions/appropriations, as laid down in MFI Ordinance 2001 and the Prudential Regulations for Microfinance Banks, have been made.

CORPORATE GOVERNANCE (G)

<u>Regulation G – 1:</u> Size and Composition of the Board

MFBs shall ensure that the skill-mix of their Board is compatible with the objectives, plans and functions of the MFB and that the board is in a position to give direction to the executive management and steer the MFB in the desired direction.

The size and composition of Board of Directors of MFBs shall be as under:

i. Minimum of seven (7) members.
ii. Not more than 25% of the members from the same family.
iii. At least two (2) or one third of total Board strength should be independent members, whichever is higher.
iv. Maximum two members including President/CEO as Executive directors.
v. Chairman who is not the President/CEO of the MFB.
vi. The Board shall have at least one female member who should not be a close relative of any other director or sponsor shareholder of the MFB. (Note: Close relative here means spouse(s), lineal ascendants and descendants and siblings).

MFBs shall also ensure that, no sponsor shareholder shall be appointed in the MFB in any capacity except as director on the board, President/CEO and/or Executive Director of the MFB, subject to compliance with FPT Criteria and other regulatory requirements.

The criteria for fulfilment of Board vacancies and their reappointments shall be governed under relevant provisions of Companies Act 2017.

Regulation G – 2: Remuneration to Directors

MFBs shall pay a reasonable and appropriate remuneration to their Board members, as per the following parameters:

a) MFBs shall have a Board approved “Remuneration Policy” to pay a ‘reasonable fee’ to their non-executive directors for attending board meetings.

b) Remuneration shall invariably be fixed in Pakistani rupees; however, payment of the same can be made to foreign directors in equivalent foreign currency, where necessary.

c) Remuneration of a director (including Chairman) for attending a board and/or its committee meeting(s) shall not exceed Rs. 100,000 per meeting.

d) These are the maximum remuneration limits. Microfinance Banks may determine remuneration of their Board members (including the Chairman) taking into consideration their own governance structure, the level of responsibility & expertise of the concerned directors.

e) Traveling, boarding and lodging expenses of a Director for attending Board and/or its committee meeting(s) shall be paid by the MFB at actuals. In this regard, the Remuneration policy shall clearly specify the parameters for such expenses whereby additional costs should be borne by the concerned director. MFBs shall also ensure that no additional payments or perquisites are paid to the Non-executive directors and Chairman except as mentioned above.

f) The Executive directors will only be paid usual TA/DA as per MFBs’ standard rules and regulations.

g) The Remuneration policy shall ensure that remuneration to Directors commensurate with their qualification, experience besides responsibilities assigned and performance thereto.

h) The Remuneration policy should outline performance indicators to evaluate performance of Board members and adequately envisage provisions for accountability of Directors for their conduct according to the scope of their responsibilities and scale of remuneration.

i) No consultancy or allied work shall be awarded to a Director or to the firm(s), institution(s) or company(ies) etc. in which he individually and/or in concert with other Directors of the same MFB, holds substantial interest.

j) Administrative expenses pertaining to the office, staff and security allocated to the Chairman, if so required, should be determined rationally.

k) The remuneration and other benefit/facility provided to the Board members, shall be disclosed in the annual financial statements in a proper and transparent manner.

<u>Regulation G – 3:</u> Responsibilities of the Board of Directors

The Board of Directors of MFBs shall:

i. Define vision & mission and set strategic goals & objectives.

ii. Approve annual business plan, and monitor its progress on regular basis.

iii. Undertake and fulfill their duties & responsibilities keeping in view their obligations under the applicable laws and regulations.

iv. Ensure that the MFB maintains high standards of disclosure, transparency, fair treatment with consumers, and compliance with rules and regulations.

v. Be independent of the influence of the management and should know its responsibilities and powers in clear terms. The board shall focus on policymaking, direction, oversight, supervision of the affairs/business of the MFB and shall not play any role in the day to-day operations.

vi. Attend training program(s) on corporate governance, information technology, cybersecurity and AML/ CFT etc. within first year of their directorship to be able to play effective role as a director on the board of MFB. However, those Directors who have already attended such programs or have served on the board of any foreign corporate body shall be exempted from such training programs.

vii. Induct appropriately qualified and experienced CEO and management, and assess their performance. Recommend re-appointment of Chief Executive Officer/President and members of the board on the basis of their performance, and ensure appropriate skill-mix in the board composition.

viii. Ensure that succession policy is in place for key management positions.

ix. Clearly define the authorities and key responsibilities of both the directors and the Senior management without delegating its policy-making powers to the management and shall ensure that the management is in the hands of qualified personnel.

x. Approve and ensure implementation & compliance of internal policies relating to business and operations. Moreover, existing policies shall be reviewed and updated periodically or whenever circumstances justify.

xi. Hold frequent/regular meetings (not less than once every quarter). The individual directors of an MFB shall attend at least half of the meetings held in a financial year. The board should ensure appropriate Information system for receiving sufficient information from management on the agenda items well in advance of each meeting to be able to effectively participate in and contribute to each meeting.

xii. Form specialized committees with well-defined objectives, authorities and tenure. These committees, preferably comprising of 'Non-Executive' Board members, shall oversee areas like audit, risk management, compensation, consumer protection etc. These committees of the board shall not indulge in day-to-day affairs/operations of the MFB and shall apprise the board of their activities, findings, and recommendations on regular basis.

xiii. Ensure that permanent committees of the board have charters approved by the board as a whole.

xiv. Ensure that the chairperson of the audit committee of the board is an independent director and shall not include any member from the management. The audit committee must include an expert on accounting and financial analysis. It must meet with the external auditors in the absence of management.

xv. The Board should determine TORs of the board committee specifying duties, authorities and composition.

xvi. The board must ensure accurate recording of minutes of board of directors and general meetings reflecting the key deliberations, rationale for each decision made, and any significant concerns or dissenting views. Further, minutes of the board meetings shall include details of matters decided/resolved through circulation. The board shall ensure that the deliberations made by the participating board member(s) are duly reflected in the minutes of the meeting(s) using name-tags.

xvii. The board shall ensure that professional standards and corporate values are in place that promote high integrity among senior management and other employees in the form of a "Code of Conduct".

Regulation G – 4: Fit and Proper Test

The Board Members, Sponsor shareholders, Key executives and President/Chief Executive are custodians of public savings deposited with the MFBs. Thus, they should not only be persons of established integrity and track record, but should also have necessary capacity, qualification and experience to effectively undertake their respective responsibilities and functions in order to lead and steer the MFB as a commercially viable and socially responsible financial institution.

SBP has, formulated "Fit & Proper Test" for selection/appointment, re-appointment/renewal, and interim appointment of the Board Members, Sponsor shareholders, Key executives and President/Chief Executive of Microfinance banks. The criterion is given at Annexure - D.

For appointment of key executives, SBP's prior approval is not required; however, MFBs shall furnish information of their key executives to SBP.

MFBs shall conduct prior self-assessment of the fitness and propriety of their Board Members, Presidents/CEOs, Sponsor shareholders and Key Executives and furnish an undertaking to this effect as per enclosed format (Annexure E – 4). It is the primary responsibility of the MFB and the interested person to ensure that the FPT criteria set forth in these regulations are complied with. For this purpose, all MFBs are required to develop internal Standard Operating Procedures (SOPs) to conduct prior self-assessment of their Sponsor shareholders (individual and companies), Directors, President/CEO and Key Executives in order to satisfy themselves that the proposed persons are eligible in light of the applicable laws, rules and regulations. Moreover, the SOPs shall also envisage appropriate screening procedures to ensure financial credibility, integrity, reputation and track record of the proposed persons. Moreover, The MFBs shall also maintain the record of such self-assessments conducted in line with SOPs for verification by SBP's team during on-site inspection/offsite evaluation.

The Board of Directors or the concerned Board Committee of the MFB shall be responsible to appoint, determine compensation package (including retirement benefits), promotion/ demotion and renewal of the employment contracts of the Key Executives. A key executive position can be filled by an executive on acting/additional charge basis provided there is no conflict of interest in both the responsibilities. Further, acting/ additional charge shall be for a limited period of time as approved by the Board of Directors. Further, the Board of Directors are encouraged to formulate an organization-wide rotation policy to ensure that the Key Executives are rotated appropriately after having served on a particular position for a reasonable time (five to six years).

Any sponsor shareholders/beneficial owners, directors, presidents and key executives (persons subject to FPT) shall become disqualified if they are designated/proscribed or associated directly or indirectly with designated/proscribed entities/persons under United Nations Security Council Resolution or Anti-Terrorism Act 1997. All MFBs shall submit Questionnaire for assessing 'Fit & Proper Test' as per Annexure E-1, E-2 and E-3 along with a declaration by the Proposing MFB' as per Annexure E-5 to SBP confirming that the person(s) subject to FPT have been verified through National Database and Registration Authority and screened against the list(s) of designated/proscribed entities and persons as per the applicable laws, rules and regulations.

Initial fitness & proprietary clearance is necessary for all sponsor shareholders. However, in case of subsequent changes in shareholding pattern as a result of investment/divestment exceeding 5% shares shall render all the concerned shareholders either individually or in concert with their family, liable to seek FPT clearance. In case of legal persons, the MFBs shall be liable to submit necessary information about the ultimate beneficial owner of that legal person.

The MFB shall not have as a Director, President/CEO or key executive person who is holding any public office (by whatever designation) or office of any political party, or is a member of Senate, National Assembly, Provincial Assembly or Local Bodies. Further, a director cannot serve as the director of any other MFB.

No person can serve as Director and / or President / CEO of an MFB if he/she is holding substantial interest or is working as Chairman, Director, CEO, Chief Financial Officer, Chief Internal Auditor, Financial Advisor, Research Analyst, Trader or member (by whatever name / designation called) of:

i. Exchange Company,
ii. Stock Exchange,
iii. Corporate Brokerage firm / entity,
iv. Credit Information Bureau,
v. Any company / entity owned and controlled by the persons mentioned at (i) to (iv) above.

Explanation: A board member of Pakistan Stock Exchange may be appointed as board member of an MFB if he / she is an independent director of PSX, provided that he / she does not have any association with other categories mentioned above.

Fit & Proper Test prescribed in these regulations is continuous in nature. Therefore, all persons' subject to FPT shall immediately submit any change in the information already submitted (at the time of clearance) either through their Company Secretary or Human Resources Department to Banking Policy and Regulations Department and copy to Agricultural Credit and Financial Inclusion Department of the SBP. Violation of the instructions, circumvention, concealment, misreporting and delay in submission of information to SBP may result in withdrawal of SBP approval.

Regulation G – 5: Restriction on Certain Types of Transactions

The MFBs shall not:

i. allow any facility for speculative purposes.

ii. take unsecured exposure on its sponsors, directors or employees including their spouses, parents, and children. The rule shall not apply on deposit services offered by the MFB and loans given to employees under staff loan policy of the MFB.

iii. offer preferential treatment to the deposit accounts of its sponsors, directors or employees including their spouses, parents, and children.

iv. enter into leasing, renting and sale/purchase of any kind with their directors, officers, employees or such persons who either individually or in concert with family members beneficially owns 5% or more of the equity of the MFB. This restriction does not apply in case of purchase of vehicles, laptops, mobile phone devices and iPads by the paid directors, officers or employees of the MFBs which remained in their own use, provided such sale is covered under the employee's service rules duly approved by the Board of Directors of the MFB and is effected by the MFB at least at book value at the date of such transaction.

v. Hold, deal or trade in real estate except for use of MFB itself.

Regulation G – 6: Internal Audit

The MFBs shall have an Internal Audit Department manned by professionals/persons having prior audit experience in MFBs/Banks/Financial Institutions. MFBs must ensure that the Internal Audit function is able to perform independently without external assistance. Moreover, audit findings/reports may not be shared with external/group entities, except in a consolidated form and with prior approval of board's audit committee. The Head of the Department shall report directly to the Board of Directors or to an Audit Committee of the Board which shall inter alia evaluate his/her performance annually. However, Head of Internal Audit may report administratively to the President/CEO.

This regulation may be read in conjunction with BPRD Circular No. 02 of 2019 titled "Internal Audit Function" and other instructions issued on the subject from time to time.

Regulation G – 7: Policy Frameworks

The MFBs shall formulate policies for all functional areas of operations including but not restricted to risk management, micro-credit, deposit operations, investments, internal audit, human resources, and rescheduling / restructuring / Charge-off of loans / advances/digital financial services/Branchless banking/pricing etc. These policies shall be duly approved by the Board of Directors. The Board shall also be responsible to review and update existing policies periodically and whenever circumstances justify it.

Regulation G – 8: Guidelines on Internal Controls and Risk Management

The MFBs shall follow at minimum the instructions and standards given in the guidelines on i) Risk Management (ii) Internal Controls iii) IT Security and iv) Business Continuity Management. The guidelines are given at Annexure - F. MFBs may further follow instructions and standards issued by SBP from time to time in these areas.

Regulation G – 9: Credit Rating

The MFBs shall get themselves rated by any of the rating agencies on the approved panel of SBP or any international microfinance rating agency, with prior approval of SBP, within three years of grant of license by SBP to operate as MFB or within one year of commencement of deposit mobilization services whichever is earlier.

The credit rating shall be an ongoing process and updated on a regular basis from year to year within four months of the close of financial year after the first rating as stated in the first paragraph. The rating report shall be submitted to Agricultural Credit & Financial Inclusion Department, and Banking Supervision Departments of SBP within 7 days of notification of the latest rating. The rating shall also be disclosed to the public within 15 days of the notification of the latest rating by the rating agency besides being placed on MFB’s website.

Regulation G – 10: Declaration of Fidelity and Secrecy

Every member, director, Key executive, auditor and staff member (including individuals, engaged on a temporary/ contractual basis, who may have access to clients’ and other proprietary information) of the microfinance bank shall, before entering upon his office and performance of duties, make a declaration of fidelity and secrecy in the form as prescribed in Annexure - G**.** This shall apply on external auditors, project based temporary/contractual staff, firms working for MFBs under SLAs, group employees who may be engaged temporarily with the MFB.

Regulation G – 11: Contributions and Donations for Charitable, Social, Educational and Public Welfare Purposes

MFBs shall strictly observe the following rules in the matter of making any donation/contribution for charitable, social, educational or public welfare purposes:

i. The MFBs shall develop policy/guidelines duly approved by their Board of Directors for making donations/contributions.

ii. Only those MFBs which meet provisioning and capital adequacy requirements prescribed by the SBP and pay positive rates of return to their depositors can make donations/contribution.

iii. The total donations/contributions made by the MFBs during the year shall not exceed such amount as approved by their Board of Directors.

iv. All donations or contributions to be made during the year must be specifically approved by the Board of Directors on pre or post facto basis.

MFBs shall expressly disclose in their annual audited financial statements the total donation/contribution made during the year along with names of donees, to whom total donations/ contributions during the year were made in excess of Rs 100,000/. In case of donations where any director or his family members have interest in the donee, the names of such directors, their interest in the donee and the names and addresses of all donees, shall also be given**.**

OPERATIONS (O)

Regulation O – 1: Cash Payments Outside the Authorized Place of Business

The MFBs shall not undertake any business of cash payments at any place other than the authorized place of business (i.e. branches / sub-branches/permanent booth). However, this rule shall not apply in case of Automated Teller Machines (ATMs), Mobile banking and Branchless banking where permission has separately been obtained from the SBP.

Regulation O – 2: Reconciliation/Settlement of Account Entries

The entries booked in the Inter-Branch Accounts and/or Suspense Account must be reconciled/cleared and taken to the proper heads of accounts within a period of 30 days from the date entry is made in the aforementioned accounts.

The above instruction shall not apply on the entries related to outstanding amount of the following, which may either be recorded in their respective head of accounts (1-7) or classified in other assets (8-9);

1. Entries made on account of tax at source.
2. Advance tax paid.
3. Tax recoverable.
4. Advance expense on new branches.
5. Advance rent paid.
6. Legal expenses.
7. Mark-up/service charge recoverable.
8. Premium on Crop Loan Insurance Scheme (CLIS) receivable from Government of Pakistan (GoP). The outstanding amount shall, however, be reconciled/cleared immediately on reimbursement of premium amount from the GoP.
9. Frauds and forgeries, cash theft and looted, payments against equity, and contributory payments of capital nature to be capitalized at a later stage. The exclusion of entries relating to frauds and forgeries, cash theft and looted will, however, be subject to the condition that the same are cleared immediately on receipt of insurance claims.

MFBs shall institute an effective internal control system for the operations of Inter-Branch and Suspense Accounts, which ensures reconciliation/clearing of the entries in shortest possible time and also clearly fixes the responsibilities on the official(s) for neglecting the timely reconciliation and clearance.

Regulation O – 3: Deposits

Deposit operations of MFBs shall be carried out in line with the following parameters:

i. MFBs shall develop appropriate products for attracting deposits and encouraging savings, especially small savings from low-income and underserved segments particularly women.

ii. MFBs shall entertain requests to open deposit accounts by persons who meet the requirements laid out in the AML/CFT/CPF Regulations and, other instructions issued by the SBP besides their own policies approved by the board.

iii. MFBs shall ensure that all terms and conditions for the operation of an account, especially in case of its dormancy, closing and/or subsequent reactivation are brought into the knowledge of the customer at the time of account opening. The terms and conditions (including charges recoverable) shall be clearly documented in the Account Opening Form/Application (both in English and Urdu) and must be signed by the account holders, to signify that they have been read and understood.

iv. MFBs are encouraged to utilize technology innovations and integrations, to enhance the outreach and usefulness of their deposit services besides adding convenience to the customer onboarding process.

A. Service Charges, Minimum Balance Requirements and Remuneration

For all types of profit and loss deposit accounts (except those with added services):

i. MFBs shall not levy service charges for their deposit services.

ii. There shall be no minimum balance requirements. However, MFBs may require an initial balance not exceeding Rs. 100/- to open an account.

iii. MFBs shall pay profit invariably on "Profit and loss sharing (PLS) Accounts" without any condition of minimum balance in accordance with instructions issued by SBP from time to time.

iv. MFBs shall fix its rates of service charges, which are commensurate with the quality of service they render to the customers, on half yearly basis in advance for the half year January-June and July-December. Each MFB shall get its schedule of charges notified as to be available to its constituents at least 7 days before the commencement of the half year during which the rates shall remain in force at all places of business. MFBs shall be required to provide a copy of the schedule of charges to the Banking Policy & Regulations Department of the SBP before the commencement of the related half-year. Further, MFBs shall also place the Schedule of Charges on their websites for information of the general public and use mediums like SMS alerts, emails and e-banking user interface to disseminate new/revised charges. No change in the notified schedule of charges will be allowed during the period in which these are in force.

B. Statement of Account

MFBs shall provide at least half yearly statements of account for all accounts having an average daily balance of Rs. 5,000/- and above. MFBs may issue statements of account either through surface mail (registered or courier), email address or other appropriate means as desired by the customer. For accounts below average daily balance of Rs. 5,000/-, MFBs shall develop an appropriate policy for issuing statements of account to the concerned depositors.

MFBs shall make all reasonable efforts to update the customers' records including address of the account holders if statements of account are returned / undelivered.

Regulation O – 4: Consumer Protection

A. Financial Literacy

Since the customers of MFBs often lack awareness about their rights and obligations, each MFB shall therefore develop and conduct a basic financial literacy program on periodic basis, helping them to make informed financial decisions. The program at minimum shall cover charges/fees, interest rate calculation, repayment schedules, customers' rights and obligations and other terms and conditions of all financial services (loan, deposit, insurance, payments etc.) that MFB offers. In addition, the program shall also educate customers about how to lodge a complaint and track the resolution of complaints. Furthermore, the MFBs should also conduct periodic surveys to assess the impact of the financial literacy program on the customers' knowledge, behavior, and satisfaction. The survey results should be used to improve the program design and delivery.

B. Transparency and Disclosure

While extending any service to a customer, the MFBs shall lay down detailed terms and conditions which at minimum must:

i. Encompass the repayment schedule, if establishing a lending relationship, which discloses the period and amounts to be paid as principal, mark-up, and fees. The schedule must clearly disclose the Annualized Percentage Rate (APR).

ii. Be drawn up in English, Urdu or any other regional language considered to be appropriate in view of clients' ability to understand.

iii. Be displayed at a prominent and easily accessible places of business such as the entrances or windows of branches, MFB's website and mobile application etc.

iv. Include details of potential factors that may induce changes in fees and service charges.

v. Be read-out, copied and provided to customers after they are signed.

vi. Not be discriminatory on the basis of race, gender, ethnicity and religion etc.

In addition, product disclosure requirements issued through BC&CPD Circular No.2 of 2016 and other instructions on the subject issued from time to time shall be followed.

C. Complaint Redressal

In order to deal with aggrieved customers, all MFBs are advised to follow Consumer Grievance Handling Mechanism (CGHM) issued vide BC&CPD Circular No. 01 of 2016, Instructions to further strengthen CGHM issued vide BC&CPD Circular Letter No. 02 of 2021; instructions on Call Center Management issued vide BC&CPD Circular No. 03 of 2021 and other related instructions issued from time to time.

D. Collection Practices

Each MFB shall develop a code for debt collection practices duly approved by its BoD. The code shall be inclusive of at least the following

i. Before proceeding for debt collection/recovery from their customers / borrowers, the MFBs shall ensure to provide him/her all information relating to payments fallen due. A minimum of 14 days' notice will be served to the customer / borrower through letter/SMS advising him/her to make overdue payment, before a visit to his/her residence / business place is undertaken in a lawful manner to negotiate recovery of the outstanding amounts. Advance notice will be required to the customer when MFBs staff picks up the payment and if it is done on customer's request then it should be properly recorded.

ii. MFBs in their collection/recovery efforts shall ensure that (a) the customers / borrowers are not contacted at an inconvenient time (b) proper disclosure of identity, name of the bank and the purpose of call is provided (c) only lawful and acceptable business language and professional attitude is adopted in establishing such contact.

iii. MFBs shall also ensure that (a) collection calls are properly recorded (b) customers / borrowers are contacted at the given address/phone numbers and in case they cannot be contacted, at alternate address/phone number obtained through collection efforts (c) "Visit Reports" shall be kept on record in the form of hard copy or on electronic collection systems for at least six months (d) collection staff shall not harass their family members. However, necessary information could be obtained from family/friends/third party of the borrower if he/she is not in contact for 30 days after the first missed payment.

iv. MFBs are advised to ensure that (a) their collection/recovery staff do not transfer or misuse any personal data of customers / borrowers without their prior approval (b) any information of customer/borrower provided to the collecting staff are properly documented.

In order to effectively control the functions of collection/recovery and the human resources engaged in this process, MFBs shall ensure the followings:

i) Frame a code of lawful conduct for recovery staff.
ii) Introduce a well-defined mechanism for addressing complaints against the collection/recovery staff.
iii) Undertake a periodical review of their recovery procedures / mechanism for improvement in line with law, market practice/development.

iv) Engage suitably qualified staff in collection/recovery and provide them necessary training.
v) Regularly monitor the activities of collection/ recovery staff / agencies.

Regulation O – 5: Submission of Quarterly Returns/Data

The MFBs shall submit their quarterly data online on prescribed Quarterly Data File Structure (DFS) under Reporting Chart of Accounts (RCOA) through Data Acquisition Portal (DAP) maintained at SBP as per laid down instructions. Further, MFBs shall ensure submission of any additional or special data on timely basis to the SBP, as and when required.

Regulation O – 6: Window Dressing

MFBs shall refrain from adopting any measures or practices whereby they would either artificially or temporarily show an ostensibly different position of MFBs' accounts as given in their financial statements. Particular care shall be taken in disclosing their deposits, minimum capital requirement, non-performing loans/assets, provisioning, profit, inter-branch and inter-bank accounts, etc.

Regulation O – 7: Permission Regarding Receipt of Grants

MFBs shall ensure obtaining prior permission from their BOD before receiving any type of grants. However, to receive grants, MFBs shall ensure adherence to the following minimum conditions;

a) Purpose of grant is in line with objectives of the MFB as stated in the MFI Ordinance 2001 and its Memorandum & Article of Association.

b) Company Secretary shall certify that purpose of grant and modalities of the agreement do not violate the applicable laws and regulatory instructions.

c) Proper record of grants received shall be maintained and readily available for review of SBP inspection team. Further, this shall also be disclosed in the periodic financial statements.

d) Formal project completion report for which the grant was received shall be prepared and shared with the grant awarding institution besides being submitted to the BOD for their review.

MFBS shall intimate details of grants received within a week to Agriculture Credit & Financial Inclusion department of the SBP.

Regulation O-8: 'Reporting to Electronic Credit Information Bureau (eCIB)-SBP

MFBs shall follow instructions related to Electronic Credit Information Bureau (ECIB) vide SBP' master circular on ECIB issued vide BC&CPD' Circular No. 06 of 2021 and other instructions issued on the subject from time to time.

……………………………….

ANNEXURES

Annexure – A

Instructions on Calculation of Capital Adequacy Ratio (CAR)

Every MFB shall maintain a minimum capital adequacy ratio (CAR) which shall not be less than fifteen percent (15%) of its total risk weighted assets (TRWA). The CAR shall be calculated as

$$CAR = \frac{Total\ Eligible\ Capital}{Total\ Risk\ Weighted\ Assets}$$

A.1 Total Eligible Capital (Numerator of the ratio)

The Eligible Capital refers to the capital that is arrived at after making the applicable deductions. For the purpose of calculating Capital Adequacy Ratio (CAR), the Total Eligible Capital will be the sum of the following:

a) Tier 1 Capital (going-concern capital or core capital)
   i. Common Equity Tier 1 (CET1)
   ii. Additional Tier 1 (AT1)

b) Tier 2 Capital (gone-concern capital or supplementary capital)

A.1.1. Common Equity Tier 1 (CET1)

CET1 shall be the sum of the following items:

i. Fully paid up (common shares) capital
ii. Balance in share premium account
iii. Reserve for Issue of Bonus Shares
iv. iv. General/ Statutory Reserves as disclosed on the balance-sheet
v. Un-appropriated profits

Less

i Un-appropriated losses
ii Intangible assets/ goodwill (net of any associated deferred tax liability)
iii Shortfall in provisions required against classified assets
iv Deficit on account of revaluation
v Deferred Tax Assets (net of deferred tax liabilities) subject to transitional arrangements.
vi Significant Investment (more than 10% of the issued shares of the entity) in the capital of financial or commercial entities

A.1.2. Additional Tier 1 Capital (AT1):

Additional Tier 1 capital (e.g. perpetual non-cumulative preference shares) shall include instruments issued by the MFBs that meet the qualifying criteria as specified at Annexure-2 and Annexure-5 of SBP Basel III instructions issued under BPRD circular No. 6 of 2013.

The inclusion of AT1 capital for CAR purposes shall be capped at 25 percent of the CET1 capital (after all deductions mentioned at CET1 level).

A.1.3. Tier 2 Capital (T2):

The total of Tier-2 capital shall be eligible up to a maximum of 41.67 percent of the CET1 capital (after all deductions mentioned at CET1) for inclusion in the capital base. The Tier 2 capital shall include the following elements.

i. Subordinated debt:

The subordinated debt shall qualify for inclusion in the Tier-2 capital subject to fulfillment of the eligibility criteria as specified at Annexure-3 and Annexure-5 of SBP Basel III instructions issued under BPRD circular # 6 of 2013. Notably, MFBs can raise subordinated debt from any person or entity, preferably from the sponsors.

ii. Revaluation Reserves (net of deficits, if any):

Revaluation reserves shall be the reserves created by revaluation of fixed assets and AFS securities held by the MFB. The assets and investments must be prudently valued fully taking into account the possibility of price fluctuations and forced sale value. Revaluation reserves (net of taxes) reflecting the difference between the book value and the market value will be eligible up to 100% for inclusion under Tier-2 Capital subject to the condition that the reasonableness of the revalued amount of fixed assets is duly certified by the external auditors of the MFB.

iii. General Provisions or General Reserves for loan losses, Depositors' Protection Fund: These reserves shall include only such provisions which are not created against identified losses and are as such freely available to meet unidentified losses. These provisions or reserves will be limited to a maximum of 1.25% of the total risk weighted assets.

A.1.4. Regulatory Deductions from CET1:

In order to arrive at the eligible regulatory capital for the purpose of calculating CAR, the banks are required to make the following deductions from CET1.

i. Intangible Assets/ Goodwill:

The book value of goodwill and other intangible assets like software, brand value etc., will be deducted net of any associated deferred tax liabilities.

ii. Shortfall in provisions required against classified assets:

Shortfall in provisions against classified assets will be deducted from CET1. The full amount of shortfall will be deducted without considering/netting any tax effects that could be expected to occur if provisions were to rise.

iii. Deficit on account of revaluation:

The net deficit (after tax) on account of revaluation (i.e. Available for Sale category and on fixed assets) shall be deducted from CET1. The net surplus/ (deficit) on Available for Sale securities and revaluation of fixed assets will be calculated on portfolio basis. If net amount (after tax) is surplus it will be included in Tier-2 capital, and if the net amount is deficit (after tax) it will be deducted from the CET1.

iv. Deferred tax assets (DTA):

All DTAs will be deducted in full net of deferred tax liabilities (DTLs). The DTLs permitted to be netted against DTAs will exclude the amounts that have been netted against the deduction of goodwill and intangibles.

An over-installment of tax or any receivable from the local tax authority which is classified as current tax assets for accounting purposes and recovery of such receivable do not rely on the future profitability of the bank will be assigned the sovereign risk weighting of 0%.

Transitional Arrangements:

The regulatory capital adjustment pertaining to net DTAs shall start in a phased manner starting from December 31, 2015 @ 25 percent per annum with full deduction from CET1 with effect from December 31, 2018. During the transition period, the part of DTAs which is not deducted from CET1 will attract a 100% risk weight.

Significant Investment in the capital of financial or commercial entities:

All significant investments (where an MFB owns more than 10% of the issued common share capital of the issuing entity or where the entity is an affiliate of the bank) will be fully deducted from CET1. The equity investment which is equal to or below 10% of paid-up capital of such investee entities will attract 100% risk weight.

For the purpose of this rule, the Investments include all holdings i.e. direct, indirect, synthetic holdings of capital instruments (e.g. MFB will look through holdings of mutual fund/ index securities to determine their underlying holdings of capital).

A.2 Calculating Total Risk Weighted Assets (Denominator of Ratio)

The CAR standard uses the concept of risk weighted assets for determining a bank's capital requirements. The risk weighting varies according to each asset's inherent potential for default and what the likely losses would be in case of default.

The risk weighted amount of an on-balance sheet asset is determined by multiplying its current book value (including accrued interest or revaluations, and net of any specific provision or associated depreciation) by the relevant risk weight. The **Table-B** below provides applicable risk weights for various classes of on-balance sheet assets and off balance sheet exposures.

Notes:

a) The risk weighting process shall cover all on-balance sheet and off-b alance sheet exposures except those (assets/ investments) which are deducted from CET1 capital. In order to avoid double impact, if any asset is deducted from capital then the same will not be counted for risk weighting purposes and zero risk weight will be applied to such exposures.

b) The risk weighting of 0% will apply only to that portion of a claim which is covered by a cash or cash equivalent (Govt. securities including National prize bonds, certificates of deposits or comparable instruments). For example, if a loan is partly secured by a cash deposit or cash equivalents, only the part of loan which is secured by cash equivalent will be risk weighted at 0%.

c) Similarly, guarantees must be direct, explicit, irrevocable and unconditional. Where a claim (in PKR) is partially guaranteed by Govt. of Pakistan or SBP, only the part of the claim which is fully guaranteed shall attract 0% risk weight.

d) All documentation used for collateralized transaction must be binding on all parties and legally enforceable. MFBs must take reasonable steps to ensure that the custody of collaterals is segregated from its own assets.

e) Securities/ collaterals shall be marked to market on periodic basis with appropriate margins to be maintained at all times.

f) For the calculation of operational risk weighted assets, average positive Gross Income of the bank over the past three years is to be used. Figures for any year in which gross income is negative or zero should be excluded from both numerator and denominator when calculating average.

   Gross Income (GI) is defined as the sum of net interest income and net non-interest income and shall be arrived at before accounting for: (i) provisions (including those for credit impairment), (ii) operating expenses (including fee in respect of outsourced activities), (iii) realized profits/ losses from the sale of securities, (iv) extra ordinary items/ windfalls, and (v) income from insurance.

   MFBs shall only use the figures of Gross Income as per the latest available (three years) audited accounts.

   Special Case: Where gross income of all three years is negative, in such case, the operational risk capital charge shall be determined by State Bank of Pakistan on a case to case basis.

A.3. Reporting Requirements

MFBs are required to submit CAR return as per the reporting formats attached as Table-A and Table-B within prescribed timelines.

Currently, MFBs are required to submit quarterly CAR statement within 14 working days from the end of each calendar quarter. Whereas, the annual CAR statement, duly certified by the external auditor, is required to be submitted within three months from the close of the year.

A.4. Notification Requirements

MFBs shall inform SBP immediately of:

i. Any breach of the minimum capital requirement or capital adequacy ratio as set out in these instructions and the remedial measures it has taken to address those breaches.

ii. Any concern it has about its MCR or CAR along with proposed measures to address these concerns.

A.5. Reductions in Capital

Any MFB that intends to reduce its paid-up capital, it must obtain SBP's prior written consent.

A.6. Penalty for Non-Compliance

Any MFB that fails to meet the above mentioned regulatory capital requirements within the stipulated period shall render itself liable to the following actions:

i. Imposition of penalties and/ or such restrictions on its business including restrictions on acceptance of deposits and lending as may be deemed fit by SBP.

ii. Cancellation of the MFB license if SBP believes that the bank is not in a position to meet the MCR or CAR requirements.

Table-A

NAME OF MICROFINANCE BANK

CAPITAL ADEQUACY RATIO AS OF XX.XX.XXXX

#	ITEMS		Amount
1	**Common Equity** 1.1	**Tier-1 (CET1)** Fully Paid-up Capital	xxx
	1.2	Balance in Share Premium Account	xxx
	1.3	Discount on issue of shares (insert negative amount)	
	1.4	Reserve for issuance of Bonus Shares	xxx
	1.5	General/ Statutory Reserves as disclosed in the Balance Sheet	xxx
	1.6	Un-appropriated Profit/(Loss)	xxx
	1.7	**Sub-Total (1.1 to 1.6)**	xxxxxx
	Less: 1.8	Intangible Assets/ Goodwill (net of any associated deferred tax liability)	xxx
	1.9	Shortfall in Provisions required against Classified Assets	xxx
	1.10	Deficit on account of revaluation	xxx
	1.11	Deferred Tax Assets (net of deferred tax liabilities) – subject to transitional arrangements	xxx
	1.12	Significant Investment (more than 10% of the issued shares of the entity) in the capital of financial or commercial entities	xxx
	1.13	**Sub-Total (1.8 to 1.12)**	(xxxx)
	1.14	**CET1 Capital (1.7 - 1.13)**	**xxxxxx**
2	**Additional Tier – 1 Capital (AT1)**		
	2.1	AT1 capital held	xxx
	2.2	AT1 capital recognized for CAR (max. up to 25% CET1 as calculated at item 1.14)	xxx
	2.3	**Tier-1 Capital (1.14 + 2.2)**	**xxxx**
3	**Tier-2 Capital**		
	3.1	Freely available General Provisions or reserves for loan losses – up to maximum 1.25% of Risk Weighted Assets	xxx
	3.2	Depositors' Protection Fund	xxx
	3.3	Revaluation reserves (net of taxes)	xxx
	3.4	Subordinated debt	xxx
	3.5	**Tier-2 capital Held (sub-total 3.1 to 3.4)**	**xxxx**
	3.6	**Tier-2 capital recognized for CAR** (max. up to 41.67% of CET1 as calculated at item 1.14)	**xxxxxx**
4	**Total Capital (2.3 + 3.6)**		
5	**Capital Adequacy Ratio**		
	5.1	Risk Weighted Assets (as per Table B)	xxxx
	5.2	Minimum Capital Requirement (15% of Total Risk Weighted Assets as per item 5.1 above)	xxx
	5.3	Total Capital Held [As per Item 4 above]	xxx
	5.4	Capital Surplus/(Shortfall) – (5.3 - 5.2)	xxx
	5.5	Capital Adequacy Ratio (5.3 / 5.1 x 100)	xxx

Table-B

Risk Weighted Assets (as of ____________________)

S.No.	ITEMS	Book Value	Risk Weight	Adjusted Value
1	**Cash**		0%	
2	**Balances with Central Banks:** 2.1 With State Bank of Pakistan 2.2 With NBP (only for such functions where NBP performs similar role as SBP)		 0% 0%	
3	**Balances with Banks** 3.1 With Scheduled Banks in Pakistan		 20%	
4	**Investments in:** 4.1 Treasury Bills 4.2 Federal / Pakistan Investment Bonds 4.3 Other securities of Federal Government 4.4 Debentures, TFCs etc. of enterprises owned/ controlled by Govt. (a) Guaranteed by Federal Govt./SBP (b) Not guaranteed by Federal Govt./SBP 4.5 Debentures, TFCs etc. of private sector enterprises 4.6 Marketable Securities (Shares / Mutual Funds) 4.7 Other Investments (TDRs of Banks/MFBs)		 0% 0% 0% 0% 50% 100% 100% 20%	
5	**Loans & Advances** (Less Cash Margin and Govt. Securities held) 5.1 Loans guaranteed by Federal Govt./ SBP 5.2 Loans secured by deposits duly pledged 5.3 Loan secured by Gold 5.2 Microcredit 5.3 Loans fully secured by mortgage of residential or commercial property 5.4 Staff loans 5.5 Others (please specify)		 0% 0% 20% 100% 50% 0% 100%	
6	**Fixed Assets (net of accumulated depreciation)**		100%	
7	**Other Assets** 7.1 Advance tax 7.2 Deposits & prepayments 7.3 Accrued income on Advances 7.4 Accrued income on deposits accounts 7.5 Accrued income on investments - PIBs/T-Bills 7.6 Accrued income on investments – Others 7.7 Other receivable		 0% 100% 100% 100% 0% 100% 100%	

8	**Off-Balance Sheet items** 8.1 Direct credit substitute (financial guarantees, general standby LC, Acceptances etc.) 8.2 Transaction related contingent liabilities (performance bonds, bid bonds, SBLC related to particular transaction etc.) 8.3 Other short term off-balance sheet items or contingent liabilities (maturity less than one year) 8.4 Other long-term off-balance items or contingent liabilities (maturity greater than one year)		100% 50% 20% 50%	
9	**Operational Risk** 9.1 Average Gross Income over the previous three years (as per the latest available audited accounts)		20%	
	TOTAL			

Annexure-B

LIABILITIES SUBJECT TO CRR	LIABILITIES EXEMPTED FROM CRR
a) All Current Deposits including customers, banks and other financial institutions b) All Savings Deposits including customers,banks and other financial institutions c) Special Notice Deposits including customers,banks and other financial institutions d) Short Term Deposits including customers, banks and other financial institutions with tenor of less than 1 year e) Overdue Fixed Deposits including those of customers, banks and other financial institutions f) Call Deposits including those of customers, banks and other financial institutions g) Unclaimed balances Accounts h) All other Deposits payable to public on demand e.g. Payment Orders, Telegraphic/Mail Transfers, Outstanding Drafts, Demand Drafts, Certificates Payable,etc. i) All borrowings unless otherwise exempted j) Profit/Return/Mark up/Interest accrued onall above Accounts k) Margin on Guarantees l) Locker's Keys Security Deposits m) Unclaimed Dividend/Dividend Payable n) Security Deposits Account (Amount deposited by Supplier of Stationery and Furniture etc., as security) o) Sundry Deposits Account p) Mark up/Interest accrued q) Any other miscellaneous liabilities payable on demand.	a) Fixed/Term Deposits of customers, banks and other financial institutions with tenor of 1year and above. b) Profit/Return/Interest accrued on above accounts c) Borrowing from SBP, money at call & shortnotice and other inter-bank borrowings from scheduled banks . d) Provision for taxation, staff benefits andaccrued expenses e) Any other miscellaneous liabilities payableon notice or after specified period

Annexure-B-1

Liabilities Subject to SLR	Liabilities Exempted From Maintenance of SLR
a) All Current Deposits including customers,banks and other financial institutions b) All Savings Deposits including customers,banks and other financial institutions c) Special Notice Deposits including customers, banks and other financial institutions d) Short Term Deposits including customers,banks and other financial institutions with tenor of less than 1 year e) Overdue Fixed Deposits including those of customers, banks and other financial institutions f) Call Deposits including those of customers,banks and other financial institutions g) Unclaimed balances Accounts h) All other Deposits payable to public on demand e.g. Payment Orders, telegraphic/Mail Transfers, Outstanding Drafts, Demand Drafts, Certificates Payable, etc. i) All borrowings unless otherwise exempted j) Profit/Return/Mark up/Interest accrued onall above Accounts k) Margin on LCs l) Margin on Guarantees m) Locker's Keys Security Deposits n) Unclaimed Dividend/Dividend Payable o) Security Deposits Account (Amount deposited by Supplier of Stationery and Furniture etc., as security) p) Sundry Deposits Account q) Mark up/Interest accrued r) Any other miscellaneous liabilities payable on demand	a) Fixed/Term Deposits of customers, banks andother financial institutions with tenor of 1 year and above. b) Profit/Return/Interest accrued on above accounts c) Borrowing from SBP, money at call & shortnotice and other inter-bank borrowings fromscheduled banks. d) Provision for taxation, staff benefits and accrued expenses e) Any other miscellaneous liabilities payable onnotice or after specified period

Annexure – D

Fit & Proper Test Criteria for Members of Board of Directors, President /Sponsor shareholders and Key Executives of Microfinance Banks (MFBs)

In order to ensure that MFBs' Board Members, Presidents/CEOs, Sponsor shareholders and Key Executives are persons of established integrity and track record and have the necessary capacity, experience and exposure to manage the affairs of the bank and public funds, the following Fit and Proper Test criteria has been developed:

1. Integrity, Honesty and Reputation

A person shall not be eligible to become a Sponsor shareholder, Director, President/CEO or Key executive of an MFB, if the person:

i) is disqualified/ineligible under Microfinance Institutions Ordinance 2001, Companies Act 2017 and other applicable laws, rules and regulations;

ii) is in default of payment of dues owed to any financial institution in personal capacity;

iii) is associated as executive director/sponsor director/nominee of the sponsor and/or President/CEO of a proprietary concern, partnership firm, or corporate body excluding public sector organization, which is in default of dues owed to any financial institution;

iv) has contravened any of the requirements and standards of SBP or equivalent standards/requirements of other local or foreign regulatory authorities, professional bodies, or government bodies/agencies of such a nature that makes such person'sassociation with the MFB undesirable;

v) is a designated person / proscribed person or is associated directly or indirectly with anydesignated person / proscribed person;

vi) is convicted of or is associated directly or indirectly with any person convicted of any serious offence, including any Money Laundering/ Terrorism Financing offence or any predicate offence set out in Schedule I of the Anti-Money Laundering Act, 2010.

(**Note**: MFB shall ensure compliance with the requirements of the Companies Act 2017, as amended, with respect to beneficial owners.)

2. Experience & Qualification

This section shall apply separately for appointment of President/Chief Executive and Directors:

i) **For President / Chief Executive of MFBs:**

The President/Chief Executive shall be a person having experience of at least 10 years as senior microfinance practitioner, or 5 years as senior banker (EVP and above). The minimum qualification for President/Chief Executive shall be graduation or equivalent. MFBs, however, are encouraged to engage persons having professional and advanced qualifications in banking, finance, microfinance, economics, information technology etc.

The person appointed as President/CEO must be between 40 to 65 years of age. However, MFBs shall ensure that the age of newly appointed President/CEO should not be more than 62 years at the time of his/her FPT application to the SBP. Any existing President/CEO who has already attained the age of 65 years or attaining the age 65 years during his/her current term may continue as President till completion of the current tenure.

The MFB shall submit FPT documents of person proposed to be appointed/re-appointed as President/CEO, at least one month before start/completion of his/her term for SBP clearance. In case of re-appointment of President/CEO for consecutive term, he/she may continue the charge of his/her office while FPT clearance is pending with SBP, unless otherwise directed by SBP.

The Board shall inform SBP within 03 working days after implementing its decision to remove its President/ CEO before the expiration of his/her term of office, through the defined statutory process along with reasons recorded in writing for the same. The Chairman of the Board of Directors of the MFB shall be responsible for submission of the requisite information to SBP.

The President/CEO, whenever, decides to tender resignation before completion of his/her term in office, he/she shall inform SBP at least one month before tendering resignation.

In case of vacation of the office of President/CEO not exceeding three months due to any plausible reason (including resignation, removal, etc.), the MFB may assign acting charge of President/CEO office to manage the day-to-day affairs of the MFB to any of the existing key executives, who meets the FPT criteria of SBP prescribed for key executives. On assuming such charge, the MFB shall inform SBP in writing within three working days of the same.

Beyond three months' period, the MFB may assign acting charge of President/CEO office to a key executive who meets the FPT Criteria prescribed for the President/CEO. However, the MFB shall duly submit FPT documents of such key executive within three working days of assumption of such charge to SBP for his/her FPT clearance.

ii) **For members of Board of Directors of MFBs:**

While selecting/recommending the Board Members, the MFBs shall ensure that their Board Members have necessary competence, qualification and experience to effectively undertake their responsibilities as Board Members. The Board shall comprise of persons having senior level experience of at least 5 years in Microfinance, Banking & Finance, Micro and Small Enterprises, Social Intermediation, Poverty Alleviation, Information Technology etc. Further, the board should collectively have adequate knowledge, expertise and skill-mix related to the business model, overall size, complexity and risk profile of the MFB.

The minimum qualification for Board Members shall be graduation or equivalent. However, for persons having extensive and successful experience in above-mentioned fields, the minimum qualification limit may be relaxed.

3. **<u>For Sponsor Shareholders</u>**:

i) The sponsor shareholders shall be evaluated in terms of "Licensing requirements and Guidelines for Setting Up Microfinance Banks", issued by SBP.
ii) MFB must conduct prior self-assessment of prospective sponsor shareholder before submitting FPT documents to SBP for approval.
iii) The sponsor shareholders are required to seek prior approval of SBP along with the information as per FPT Proforma and other information as required in terms of "Licensing Requirements and Guidelines for Setting Up Microfinance Banks", issued by SBP, as the case may be. Moreover, SBP's prior approval is required for any change in the existing sponsor shareholdings.
iv) The MFB shall also ensure to give prior intimation to SBP before dealing with any investor, bank, institution or person for sale/purchase of sponsor shares of MFB and seek SBP's approval for allowing due diligence of the MFB.
v) All MFBs are required to deposit sponsor shares and subsequently acquired shares in a blocked account with Central Depository Company of Pakistan (CDC) in a manner as prescribed in SBP circular "BPRD Circular No. 09 of 2009" and other instructions issued from time to time.

4. **<u>Track Record</u>**

i) The person selected must have an impeccable track record in the companies he/she has served either in the capacity of an employee or Director/Chief Executive or as Chairman

ii) Has not been terminated or dismissed in the capacity of employee or Director/Chairman of a company.

5. <u>Conflict of Interest</u>

i) The Directors on the MFBs' Board shall not be Director of any other Microfinance Bank. He/She shall also not act as consultant, adviser or an employee of any other MFB.

ii) He/She shall avoid conflict of interest in his/her activities with, and commitments to, other organizations.

6. <u>Prior Clearance</u>

The MFBs shall submit information about the Board Members and/or President/Chief Executive Officer/Sponsor shareholder to SBP, as per the proforma enclosed as Annexure-E, E-1, E-2, E-4 and E-5, for clearance before selection/appointment or re-appointment/renewal of term of Directors and President/Chief Executive Officer/sponsor shareholder.

The appointment of other key executives will not require prior clearance of SBP. However, the MFBs while appointing key executives must themselves ensure that the incumbent(s) qualify on the basis of (i) Integrity, Honesty & Reputation, and (ii) Track record as laid down in Fit & Proper Test criteria of these regulations for President/CEO and Board Members in letter and spirit. Additionally, the MFB shall define minimum qualification and experience requirements for each key executive position in recruitment/promotion/HR policy of the MFB, duly approved by its BoDs.

The information on appointment of key executive is required to be forwarded to SBP on prescribed format at Annexure – E-3, E-4 and E-5 within seven days of assumption of the charge of the post by the incumbent. The information submitted may be checked during inspection/offsite supervision by Banking Supervision Department of SBP.

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Annexure – E

PROFORMA - FITNESS & PROPRIETARY OF CEO / BOARD MEMBERS/ SPONSOR SHAREHOLDER

Photo

1 x 1½

1. Full Name____

2. If you have changed your name, state previous name and reasons for change ______________________________
____

3. Parents and Spouse's Names

Father's Name:____

Mother's Name: ____

Spouse's Name:____

4. Date & Place of Birth: ____

5. Religion: ______________________

6. N.I.C. Number-Old: ______________________

C.N.I.C Number-New: ____________________

Passport Number: ____________________

7. N.T.N.: __________________

8. Education: ____________________________

9. Relationship with other Sponsor Directors: ______________________________________

10. Status of Directorship (shareholder or nominee): __________________________________

11. Subscribed Amount: ____________________________

12. Personal Net Worth (Certified copy of Wealth Statement may be enclosed): ___________________________

13. Occupation / Profession / Trade: ____

14. Present Designation, Department and official Address
____

15. Telephone Numbers: Res.____________________Off:_________________Mobile: ___________________

16. Appointments held during the last five years (with dates):____

17. List of Companies / firms and their bankers in which sponsor directors and their family members viz. spouses, children and parents serve(d) as directors, chief executive, partner, proprietor or major shareholders holding 5% or more shares as per following format:

Name of the Sponsors Director and his / her family Members	Occupation/ Profession/ Trade	National Tax Number	NIC & Passport Number	Name of Associated Company / Firm position held & % of Shareholding	Name of the Financial Institution along with the name of the branch (account number) with which firms / companies (as per column 5) have dealings with:
1	2	3	4	5	6

National Tax Number of the Corporate Bodies	Nature of Business	Asset Base as reflected in the latest Audited Accounts of the Corporate Bodies	Dividend declared in the immediately preceding three years
7	8	9	10

18. Declaration certificate pronouncing integrity, honesty, reputation and track record of the director as per guidelines given in Annexure –D

19. Present Residential Address:

____

____

20. Permanent Residential Address:

____

____

21. Names & Addresses of three respectable persons (not relatives) who have been closely acquainted with you during last five years:____

____

Signature

Annexure – E – 1

QUESTIONNAIRE FOR ASSESSING "FIT & PROPER TEST"

Please answer the following questions by entering a tick (✓) in the appropriate box. If answer of any of these questions is in YES and need explanation, use a separate sheet with proper reference to the question.

	Yes	No
1. Have you ever been convicted/ involved in any fraud/forgery, financial crimeetc. in Pakistan or elsewhere, or are being subject to any pending proceedings leading to any conviction?		
2. Are you a dual national? If yes, please specify nationality other than Pakistani.		
3. Have you ever been associated with any illegal activity concerning bankingbusiness, deposit taking, financial dealing and other business?		
4. Have you ever been subject to any adverse findings or any settlement in civil/criminal proceedings particularly with regard to investments,financial/business, misconduct, fraud, formation or management of a corporate body etc. by SBP, other regulators, professional bodies or government bodies/agencies?		
5. Have you ever contravened any of the requirements and standards of regulatory 4 system or the equivalent standards or requirements of other regulatory authorities?		
6. Have you ever been involved with a company or firm or other organizationthat 4 has been refused registration/license to carry out trade, business etc.?		
7. Have you ever been involved with a company/firm whose registration/license has been revoked or cancelled or gone into liquidation or other similar proceedings?		
8. Have you ever been debarred for being Chief Executive, Chairman, Directoror Sponsor shareholder of a company, especially financial institutions?		
9. Have you ever been dismissed/ asked to resign/resigned in Pakistan orelsewhere in order to avoid legal or disciplinary action?		
10. Have you ever resigned from a professional or regulatory body in Pakistan or elsewhere in order to avoid legal or disciplinary action?		
11. Have you ever been disqualified/ removed by regulators/Government bodies/ agencies?		
12. Have you ever been in default of payment of dues owed to any financial institution in individual capacity or as proprietary concern or any partnership		

firm or in any private unlisted/listed company?		
13. Have you ever been in default of taxes in individual capacity or as proprietary concern or any partnership firm or in any private listed/unlisted company?		
14. Have you ever been associated as director and/or chief executive with the corporate bodies whose corporate and tax record, including custom duties, central excise and sales tax has been unsatisfactory?		
15. Have you entered into any agreement with any other person (natural or legal) which will influence the way in which you exercise your voting rights orthe way in which you otherwise behave in your relationship with the authorized entity?		
16. Are you a director on the Board of Directors of any other Financial Institution(s)/MFB (or its parent MFI, if any)?		
17. Are you a Chairman, Chief Executive, Chief Financial Officer, Chief Internal Auditor, Research Analyst or Trader (by whatever name/designation called) of an Exchange Company (firm or sole proprietorship), member of a Stock Exchange, Corporate Brokerage House?		
18. Are you owning/controlling any Exchange Company or Corporate Entity?		
19. Have you been or are you working as consultant or adviser of the MFB (or its parent MFI, if any) in which you intend to become a director?		
20. Are you directly or indirectly associated with designated/proscribed entitiesand/or persons under United Nations Security Council Resolution or Anti- Terrorism Act 1997?		
21. Are you employee of the MFB (or its parent MFI, if any)?		
22. Are you employee of a company/entity/organization where sponsor shareholders of the MFB have substantial interest?		
23. Are you a member/office bearer of any political party or member of Senate/National/Provincial Assembly/Local Body		
24. If independent director, have you enclosed declaration in this behalf?		
25. Any other information that is relevant for the purpose of SBP and needs to be mentioned?		

Signature ______________________
Name ______________________
Position ______________________
Date ______________________

Annexure – E - 2

AFFIDAVIT

(On Non-Judicial Stamp Paper)

I, ________________ son/daughter/wife of ______________________ adult, resident of ____ and holding CNIC/Passport No.______________________________do hereby state on solemn affirmation as under:-

a. that the deponent hereby confirm that the statement made and the information supplied in the attached questionnaire and the Annexure-E1 and the answers thereof are correct and that there are no other facts that are relevant for "Fit and Proper Test"

b. that the deponent undertake that the State Bank of Pakistan may seek additional information from any third party it deems necessary in view of assessing "Fit and Proper Test"

c. that the deponent undertake to bring to the attention of the State Bank of Pakistan any matter which may potentially affect my status as being someone fit and proper as and when it arise; and

d. that whatever is stated above is correct to the best of my knowledge and belief and nothing has been concealed therefrom.

DEPONENT

The Deponent is identified by me

Signature ______________________

ADVOCATE

(Name and Seal)

Solemnly affirmed before me on this________day of _______________at________________by the Deponent above named who is identified to me by________________, Advocate, who is known to me personally.

Signature____

OATH COMMISSIONER FOR TAKING AFFIDAVIT

(Name and Seal)

Annexure – E - 3

PROFORMA –FITNESS & PROPRIETARY OF KEY EXECUTIVES

Photo 1 x 1½

<table>
<tr><td colspan="6">Position and Grade held by the Executive</td></tr>
<tr><td colspan="6">Date of assumption of current position (dd/mm/yyyy)</td></tr>
<tr><td colspan="6">Full Name</td></tr>
<tr><td colspan="6">Father's Name</td></tr>
<tr><td colspan="3">Date of Birth</td><td colspan="3">Place of Birth (City and Country)</td></tr>
<tr><td colspan="3">Nationality (ies)</td><td colspan="3">NTN Number</td></tr>
<tr><td colspan="3">C.N.I.C. No
Passport No.</td><td colspan="3">N.I.C. No (Old)</td></tr>
<tr><td colspan="3">Telephone Number(s)</td><td colspan="3">Mobile Number</td></tr>
<tr><td colspan="6">Academic Qualification</td></tr>
<tr><td>Qualification</td><td colspan="2">Name & Address of Degree Awarding Institution</td><td colspan="3">Date of Completion</td></tr>
<tr><td colspan="6">Professional Qualification</td></tr>
<tr><td>Qualification</td><td colspan="2">Name & Address of Degree Awarding Institution</td><td colspan="3">Date of Completion</td></tr>
<tr><td></td><td colspan="2"></td><td colspan="3"></td></tr>
<tr><td colspan="6">Training(s); if any</td></tr>
<tr><td colspan="6">Previous Employment(s) (date-wise)</td></tr>
<tr><td colspan="3">Designation</td><td colspan="3">Department</td></tr>
<tr><td colspan="6">Official Address</td></tr>
<tr><td colspan="6">Telephone Number (s)</td></tr>
<tr><td colspan="4">Has ever been convicted of any offence?</td><td>Yes</td><td>No</td></tr>
<tr><td colspan="6">If yes, nature of offence and penalty imposed</td></tr>
<tr><td colspan="4">Has ever been censured or penalized by any financial regulator (local or foreign)?</td><td>Yes</td><td>No</td></tr>
<tr><td colspan="6">If yes, reasons for adverse findings and amount of penalty imposed (if any)</td></tr>
<tr><td colspan="4">Has ever been dismissed from employment?</td><td>Yes</td><td>No</td></tr>
<tr><td colspan="6">If yes, name of the employer and reason for dismissal</td></tr>
</table>

(Signature of the concerned official) **(Signature and Stamp of Employer)**

ANNEXURE E – 4

DECLARATION BY THE PROPOSING MFB

(To be signed either by the President/Chief Executive Officer, Head of Human Resources or the Company Secretary of the incorporated MFB)

I, ______________________ on behalf of ___________________ ***(name of proposing MFB)*** ("the proposing MFB") submit the FPT Proforma in respect of Mr./Ms. _______________ for the proposed position of ____________________ and declare that:

(i) To the best of my knowledge, information and belief, the information that is being submitted to SBP is true, accurate and supports my view that this person fulfils all the criteria for the post for which he/she is proposed.

(ii) Select ( ) as appropriate:

a) The MFB has satisfied itself that the proposed person meets the requirements of all the applicable laws, rules and regulations including Companies Ordinance, 1984, Microfinance Institutions Ordinance, 2001 and applicable FPT Criteria and is, in the opinion of the MFB, capable of fulfilling the assigned role.

OR

The MFB acknowledges that the proposed person needs an exemption from some provision(s) of the applicable laws, rules and regulations, details of which are given in the attached letter along with justifications thereof. ☐

b) The MFB has obtained copies of educational degrees/certificates and verified the same from relevant institutions/universities or obtained certified copies of verification from previous employer directly. ☐

OR

The MFB undertakes to confirm to the SBP within a period of four (4) months hereof that educational degrees/certificates shall be got verified by them and status of the same shall be communicated to SBP accordingly. ☐

c) The MFB has obtained satisfactory confidential reports from the former employer(s). ☐

Signatures & Stamp of MFB's official: ____________________

OR

The MFB undertakes to obtain confidential reports from the former employer(s) within a period of three (3) months hereof and status of the same shall be communicated to SBP accordingly. ☐

(iii) I am aware that it may be:

a. an offence and/or
b. grounds for refusal of this application and/or
c. grounds for revocation of an authorization granted on the basis of this application and/or
d. grounds for SBP to commence an administrative sanctions procedure against both myself and/or the MFB

if the undersigned and/or the MFB knowingly or recklessly

- provide false or misleading information and/or to make a false or misleading statement (which, I acknowledge, may include the withholding by me and/or the MFB of relevant information) in this application for authorization
- fail to inform and/or withhold from the SBP details of any change in circumstances/new information which is relevant and/or material to the status of the proposed person anytime from now on.
- fail to inform to SBP immediately any legal and/or contractual infirmity resulting from behavior, conduct or incapacity in whatever form any time from now on which could potentially debar the person from holding the position.

Dated this	day of

Name:	Signature

Position/Designation

For and on behalf of (name of MFB):

ANNEXURE- E-5

DECLARATION BY THE PROPOSING MFB

(To be signed either by the President/Chief Executive Officer, Head of Human Resources or the Company Secretary of the incorporated MFB)

After in-depth self-assessment of Mr./Ms.______________________ for the proposed position _______________, I, _______________________ on behalf of (name of proposing MFB) ("the proposing MFB") declare that:

a) The MFB has satisfied itself that citizenship of the proposed appointee has been verified from National Database and Registration Authority and has been submitted to State Bank of Pakistan along with the FPT documents.

OR

In case the proposed appointee is a foreign national, the bank has satisfied itself that the citizenship of the proposed appointee has been verified from the concerned embassy and has been submitted to State Bank of Pakistan along with FPT documents.

b) The MFB confirms that the name of proposed appointee is not in the list(s) of designated/proscribed individuals and entities under United Nations Security Council Resolution or Anti-Terrorism Act 1997.

c) The MFB confirms that the proposed appointee is not directly or indirectly associated with designated/proscribed entities and/or persons under United Nations Security Council Resolution or Anti-Terrorism Act 1997 and other applicable laws, rules and regulations.

Dated this	day of

Name:	Signature:

Position/Designation:

For and on behalf of (name of MFB):

Annexure-F

Guidelines on Internal Control and Risk Management

MFBs are exposed to several types and degree of risks depending on factors such as their size, complexity of business activities, scale etc. Like other financial institutions, MFBs face credit, market, liquidity, operational, compliance / legal /regulatory and reputational risks. To strengthen MFBs and increase their resilience to resist financial and economic shocks, they shall ensure to have in place appropriate mechanisms/frameworks for Business Continuity Management, Internal control, Risk Management and IT Security which commensurate with their needs.

A – INTERNAL CONTROLS

These Guidelines on Internal Controls provide a minimum set of best practices for establishing and implementing effective internal controls in Microfinance Banks (MFBs).

Internal Control refers to policies, plans and processes which are approved by the board and performed on continuous basis by the senior management and all levels of employees within the MFB. Internal controls are used to provide reasonable assurance regarding the achievement of organizational objectives. Effective and well-designed operations are prone to risk and even well trained personnel with the best of intentions can become distracted and negligent. MFBs shall therefore design and review their internal control policies and procedures taking into account the following;

- MFBs shall have in place an effective internal control system, duly approved by their board, clearly laying out the control environment and structure, recognizing risks and assessment, control activities, accounting, information & communication, and self-assessment or monitoring and correcting deficiencies.
- MFBs shall ensure implementation of internal controls mechanism and its integration into daily operations.
- MFBs shall ensure effective communication of their internal control processes and system among their employees.
- Monitoring of key risks should be part of the daily activities of the MFBs as well as periodic evaluations by the business lines and internal audit.
- MFBs shall conduct an effective and comprehensive internal audit of the internal control system.
-

The following 'Controls Principles' need to be applied by all MFBs, irrespective of size, nature and complexity of their business, while developing framework of internal controls;

- <u>Regular feature</u>: Control activities should be an integral part of the daily activities of a MFB in such a manner that it becomes ingrained in their ongoing processes rather than a year-end "fire drill" to satisfy documentation requests from auditors and supervisors.
- <u>Separation of Duties</u>: Duties should be divided so that no one person has complete control over a key function or activity.
- <u>Authorization and Approval</u>: All transactions should be authorized before recording and execution.
- <u>Custodial and Security Arrangements</u>: Responsibility for custody of assets needs to be separated from the related record keeping.
- <u>Review and Reconciliation:</u> Records should be examined and reconciled to regularly determine that transactions are properly processed, approved and booked.
- <u>Physical Controls</u>: Equipment, inventories, cash and other assets should be secured physically, counted periodically and compared with amounts shown on control records.
- <u>Training and Supervision</u>: Qualified, well-trained and supervised employees always help ensure that control processes function properly.

- Documentation: Documented policies and procedures promote employee understanding of duties and help ensure continuity during employee absences or turnover. Therefore, policies and procedures (in the form of operations manuals and desk instructions) should exist in all MFBs.
- Communication of importance of Internal Controls: Setting standards of professional integrity and
- work ethics and ensuring that all levels of personnel in their organization know the importance of internal controls and understand their role in the internal controls process and be fully engaged in the process.
- Cost/Benefit: It is for the MFBs to assess that the costs associated with control processes commensurate with the expected benefits.

B – RISK MANAGEMENT

These Guidelines on Risk Management provide a minimum set of best practices for establishing and implementing effective risk management in Microfinance Banks (MFBs). MFBs, like other financial institutions, are exposed to a spectrum of risks, which include credit risk, interest rate risk, liquidity risk, operational risk, and legal and reputation risk. Managing these risks is essential for their survival and sustainability. In this regard, MFBs shall design and review their risk management policies and procedures in light of the following:

- The MFBs shall prepare a comprehensive Risk Management and Reporting Framework (RMRF) covering all of their business activities and circumstances under which they operate and have flexibility to accommodate any changes thereof. The RMRF shall be duly approved by the Board.
- The RMRF shall outline role and responsibilities of board and senior management to identify, measure, monitor report and control relevant categories of risks especially credit, market, liquidity, operational and reputational risks.
- The MFBs shall ensure establishing clear lines of authority and responsibility for managing responsibilities for dissemination, implementation and compliance of the approved policies and procedures.
- The MFBs shall develop a system for testing and analyzing their aggregate loan portfolio on continuous basis. The MFBs in particular shall have in place mechanism to identify and correct portfolio concentration in geographies, products, economic segments, branches, and loan officers. The MFBs shall also record the risks identified through the portfolio testing and related corrective actions, and report these to their senior management.
- The BOD shall review the effectiveness of the risk management activities periodically and make appropriate changes as and when necessary. The risk review function shall be independent of those who approve and take risk. The review may use stress tests exposing the portfolio to unanticipated movements in key variables or major systemic shocks.
- The MFBs shall have in place an Asset-Liability Management Committee (ALCO) to undertake following responsibilities;

  i. Oversee the structure/composition of MFB's assets and liabilities and decide about product pricing for deposits and advances.
  ii. Decide on required maturity profile and mix of incremental assets and liabilities.
  iii. Articulate interest rate view of the bank and deciding on the future business strategy.
  iv. Review and articulate funding policy.
  v. Discuss strategies and risks in obtaining debt/loans from local and foreign lenders.

C – BUSINESS CONTINUITY MANAGEMENT (BCM)

These Guidelines on Business Continuity Management (BCM) provide a minimum set of best practices for establishing a holistic management process to identify and respond to potential events regarding operating disruptions that threatens MFBs. The quick recovery of business, after major operational disruption, is crucial in maintaining confidence in MFBs and protecting the interest of key stakeholders.

MFBs shall therefore take following actions:

- MFBs shall have in place a comprehensive plan, for BCM, duly approved by their board to ensure its ability to operate as going concerns and minimize losses in the event of severe business disruptions.
- The BCM plan shall clearly define/segregate responsibilities of board and senior management, identify critical staff and senior management, critical and time sensitive functions, location & suitability of operations back-up site and availability of necessary facilities, accessibility/movement plan, and critical documents / data.
- The MFBs shall allocate sufficient resources and knowledgeable personnel to accomplish the tasks contained in its BCM plan. MFBs shall provide training sessions and awareness programs for their staff to familiarize them with their roles, accountabilities, responsibilities and authority in response to a disruptive event.
- The MFBs shall carry out a thorough business impact analysis identifying the potential impact of uncontrolled, non-specific events on MFBs' business processes and their customers; consideration of all departments and business functions, not just data processing; and estimation of maximum allowable downtime and acceptable levels of data, operations, and financial losses.
- The MFBs shall carry out an assessment of potential business disruptions and critical business lines based upon severity and likelihood of occurrence in order of priority; a gap analysis comparing the MFBs' existing BCM, if any, to what is necessary to achieve recovery time and point objectives; an analysis of threats based upon their impact on MFBs and their customers and recovery time targets.
- The MFBs shall conduct an independent audit of their BCM plan.
- The MFBs shall make arrangements for review of their BCM plan, and are encouraged to conduct mock exercises on periodic basis.

D – INFORMATION TECHNOLOGY (IT) EFFECTIVENESS/SECURITY

These Guidelines on IT security provide a minimum set of best practices for establishing and implementing effective IT security in Microfinance Banks (MFBs). MFBs shall design and review their IT security policies and procedures in light of the following:

- The MFBs shall prepare a comprehensive IT policy, duly approved by the Board. It shall entail the process for reviewing current and future IT needs in terms of resources (hardware, software and technical expertise), ensuring effective use of existing IT resources, identifying IT related risks and adopting strategies to cope with these risks.
- The MFBs shall put in place a Disaster Recovery Plan and maintain a disaster recovery site. Disaster recovery planning shall ensure availability of resources and required technological support to businesses in an event of disaster. The plan must then be maintained, tested and audited by auditors to ensure that it remains appropriate to the needs of the MFB.
- The MFBs shall maintain a team of experienced technical and business human resources with a thorough understanding of IT Security issues. The team would streamline the IT security related process and procedures, including incident response and management and should report to the senior management / BoDs.

- The MFBs shall perform IT risk assessment on periodic basis to determine physical, environmental, administrative, and technical vulnerability as well as the potential threats (and their consequences). Risk re-assessment should be a continuing process.
- The MFBs shall conduct regular workshops/ training programs to create users' awareness.
- The MFBs shall have in place a dashboard utility for accessing information frequently required by auditors / SBP inspectors during their engagement. The requisite information includes statements of account of (GL, deposit or loan accounts), branch / bank wise affair & profit & loss, review of transactions etc.
- Those MFBs which are using alternative delivery channels (including ATMs, PoS machines, and branchless banking agents) shall opt for a third party IT security audit to ensure the adequacy of the adopted security plan and procedures and the effectiveness of the implemented controls.

…………………………………………

Annexure – G

DECLARATION OF FIDELITY AND SECRECY

I, **(insert name)** on becoming **(President/ Chairman of the Board/ Director on the Board/auditor/staff)** of the **(insert name of Microfinance Bank)** in terms of Section 26-A of the Microfinance Institutions Ordinance, 2001 do hereby solemnly & sincerely confirm/declare that I shall observe strict fidelity, secrecy and usage customary among bankers and all matters relating thereto and in particular shall not divulge or communicate any information relating to the affairs of its customers, which may come to my knowledge in discharging my duties directly or indirectly, except in circumstances in which it is in accordance with law, practice and usage customary among bankers.

Dated: Signature:______________________**Designation**:______________________

Annexure - H

Financing against Gold Backed Collateral-Instructions for MFBs

The MFBs are offering personal and business loans with gold as a security. While this provides protection to MFBs against borrowers' default, it also makes them responsible to hold the borrowers' gold (ornaments) in a secured manner. Due to increased growth of gold-backed loan portfolio, the MFBs are now dealing with gold collateral on daily basis in some way - valuation, transfer, storage, redemption, and auction. This makes it critical for MFBs to develop and implement an appropriate framework of controls to manage security, procedures, and contingency planning for gold collateral bearing in mind a probable threat scenario at any time.

Risks relating to handling of the gold collateral can be many, including lending against fake gold, tempering of gold bags, theft of gold, valuations against low carat gold, and fake borrowers. Such risks often emanate as a result of negligence and/or collusion between bank's staff, shroff, and borrowers.

Policy/product for lending against Gold

To address the above-mentioned risks, MFBs are instructed to develop an appropriate collateral handling policy duly approved by their board of directors. The policy should include criteria for authorizing branches for offering gold-backed loans, purpose of the loans, eligibility of borrowers, hiring of shroff, valuation criteria, loan processing procedures, release/auction of gold, and insurance & internal controls.

Senior management of the MFB shall review its gold-loan policy periodically based on the results and feedback received from branches. The policy shall include following:

Authorized Branches

MFB shall allow lending against gold ornaments at authorized branches only, by meeting minimum criteria including availability of physical infrastructure, existence of potential business, availability of trained staff, security arrangements etc.

MFB shall maintain an updated list of authorized branches offering gold loan product(s).

Purpose of Financing

The MFB shall record purpose of loans against gold. Following may be the purpose of the loans:

- Agriculture
- Livestock
- Small business & micro enterprises/micro entrepreneurs
- Asset purchased for agriculture or enterprise
- Housing Finance
- Any other

Note: MFBs shall maintain purpose/product wise tagging of all loans backed by gold in their MIS. To substantiate the purpose of loan, the MFBs may obtain relevant document (s) where necessary. Further, the MFB shall not lend to a borrower to purchase gold/gold ornaments.

Application Form for availing loan against gold

MFB shall incorporate following in the application form:

a. Details of borrowers as per requirements under MFB policy/SBP Regulations
b. Product details
c. Terms & Condition clearly mentioned in national language shall be the part of application form

d. Application form must contain section of "Next to Kin" or a separate certificate especially for handing over gold in case of death of borrowers.

Eligible Clients

Financing shall be made as per eligibility criteria under Prudential Regulation for Microfinance Banks and other conditions defined in MFBs' product/operational manual.

Eligibility of Gold Ornaments

Financing against gold is allowed to the extent of net gold contents of the required fitness. MFBs shall develop criteria on eligibility of gold/ gold ornament and fitness. MFBs are encouraged to incorporate relevant section in leaflet/broachers developed for clients in national or regional language.

Authorized Valuators/Goldsmith

To reduce/minimize the risk of extending finance against fake gold, the services of only well-reputed and trustworthy goldsmith/shroff shall be employed in all cases to obtain measurement, fitness and evaluation. MFB shall establish a panel of at least three Goldsmith/Shroffs under one branch to assign task of valuation randomly.

The valuation of gold ornaments shall be conducted preferably in the MFB's own branch in presence of borrower & designated bank officer. In case if valuation carried out at the place of goldsmith, MFB shall take into account security measures, proper transportation and insurance coverage.

MFB shall develop a criterion of hiring Goldsmith/ Shroff. The criteria must include:

a. Adequate number of years in business
b. Not defaulter of any bank/MFB as per e-CIB
c. Not convicted by any civil or criminal offence as per police verification report
d. Holder of valid license, member of Sarrafa Association (where applicable).

MFBs shall execute standard agreement with approved goldsmith/shroff, mentioning tenure, Terms & condition, fees etc.

Valuation of Gold

Valuation of gold ornaments must be based on the weight and fitness of the gold only. Valuation certificate issued by the goldsmith/shroff shall clearly indicate the description of the gold ornaments, fitness, gross weight, net weight of gold exclusive of stones, lace, alloy, strings, fastenings and the value of gold at the prevailing market price.

MFBs may seek valuation of the gold ornament from two Shroff/goldsmiths on sample basis with an objective of imposing control on gold smith/shroff.

Custody of Gold Ornament

To ensure safety of the gold, MFB shall maintain a minimum level of physical infrastructure including fire proof safe vault, strong room in each branch engaged in financing against gold ornaments.

The gold ornaments shall be kept in a tempered proof bags with description details, account title, account number. A tag indicating details should be tied to the bag and placed in a way to identify easily.

MFBs shall ensure dual control on keeping of gold ornament (collateral) in safe vaults by the officers duly authorized by the competent authority.

The safe vaults must be kept under strict video surveillance and authorized officers shall be responsible to maintaining and updating a proper log of the vault operations (with details on bags taken out/kept/checked) which may, on a quarterly basis, be submitted to the management for information and record.

Loan Processing

For developing a smooth lending process, MFBs shall device process flow of loan against gold- backed security and incorporate in operational manual. MFB shall clearly define roles & responsibility of MFB/Shroff/Borrower in their policy. Further, MFB shall ensure following while lending against gold loan;

a. MFB will document Turn Around Time (TAT) from receipt of loan application to disbursement.
b. MFB shall develop proper internal control mechanism to avoid any fraud/misappropriation.
c. In case of rejection of loan, MFB shall inform the client within 3 working days.

Insurance

Gold ornaments held against loans should be insured against theft, fire, riots and other possible risks. In addition, MFBs shall obtain appropriate insurance to protect borrowers' loan outstanding in case of his/her death.

Margins

MFBs shall maintain reasonable margins to cover their amount of principal and mark-up. Further, MFBs shall keep monitoring the gold prices and market fluctuation to make necessary adjustment in the margin requirements, if deemed necessary.

Release of Securities upon adjustment

On settlement / repayment of outstanding loan along with applicable markup against gold ornaments held as collateral, the gold should be returned to the borrower with acknowledgement receipt within 3 working days after the full repayment of loan. Receipt should contain details of Gold returned.

MFB shall layout procedures for release of securities in case of following situation:

- Repayment/settlement of loan
- Death of a borrower
- Absence of borrower

Further, MFB shall an updated list of such borrowers in its MIS who have settled their loans but not obtained their gold ornaments.

Default and Auctions

MFBs should develop a detailed and transparent auction process which shall at least follows:

a. In case borrower fails to repay the loan on the due date, MFB will serve **FIRST** notice with a specified timeline to settle the loan.
b. If borrower does not respond to the first notice, MFB would serve **SECOND** notice within 15 days after due date of the first notice informing the borrower that the ornament would be auctioned and outstanding loan would be adjusted.

c. On completion of 15 days after **SECOND** notice, MFB will serve **THIRD** & **FINAL** notice with Public Auction Notice mentioning the date of auction to the borrower through registered courier at least 10 days (inclusive of courier shipment time) before the auction.

In addition, MFB shall also communicate date and place of auction date through telephone/mobile phone call.

In case of prevailing gold value below Rs.100,000/-, the MFB shall call borrower, gold owner, Loan witness and panel of gold smith to participate in the auction. In case of prevailing gold value more than Rs.100,000/- MFB shall notify auction through public announcement in at least two local news paper (at least one should be in Urdu). Notice must contain details of net gold and particulars as obtained at the time of pledge.

All such pledges, which have been sold for more than the amount of loan, the surplus derived by offsetting loan amount, interest, and other charges from the sale price, the MFBs are obligated to timely inform the borrower to collect the surplus amount.

Note: MFBs should mention in bold letters in the loan application the procedure of auction process in case of nonpayment of the loan on stipulated time. Further, the MFB shall maintain detailed record of each auction.

<u>Role of Internal Audit Department</u>

Internal Audit Department of MFB shall from time to time monitor the lending and collateral management activities including verification process, loan process, safekeeping, valuation process, auction process and identify the gaps (if any) to the senior management.

Annexure-I-1

Regulation R – 8: Classification of Assets and Provisioning Requirements

Guidelines for Classification and Provisioning of Agriculture and Livestock Loans (Applicable on new loans only after the date of issuance of instructions)

Classification	Determinant	Treatment of Income	Provisions to be made
Doubtful.	Where mark-up/interest or principal is overdue by 180 days or more from the due date.	Unrealized interest / profit / mark-up to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized interest /profit / mark-up already taken to income account to be reversed and kept in Memorandum Account.	Provision of 50% of the difference resulting from the outstanding balance of principal net 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 I-4.
Loss	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 net 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 I-4.

Annexure I-2

Regulation R – 8: Classification of Assets and Provisioning Requirements
Guidelines for Classification and Provisioning of Housing Loans

Classification	Determinant	Treatment of Income	Provisioning to be made
Substandard	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	Unrealized interest / profit / mark-up to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized interest / profit / mark-up 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 net of liquid assets realizable without recourse to a court of law, and Forced Sale Value (FSV) of mortgaged properties to the extent of 75% of such FSV.
Doubtful	Where mark-up/interest or principal is overdue by one year or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal net of liquid assets realizable without recourse to a court of law, and Forced Sale Value (FSV) of mortgaged properties to the extent of 75% of such FSV.
Loss	Where mark-up/interest or principal is overdue by two years or more from the due date.	As above.	Provision of 100% of the difference resulting from the outstanding balance of principal net of liquid assets realizable without recourse to a court of law, and Forced Sale Value (FSV) of mortgaged properties to the extent of 75% of such FSV for first and second year, 50% for third and fourth year and 30% of FSV for fifth year from the date of Classification. Benefit of FSV against NPLs shall not be available after 05 years from the date of classification of financing.

Annexure I-3

Regulation R – 8: Classification of Assets and Provisioning Requirements
Guidelines for Classification and Provisioning of Microenterprise Loans

Classification	Determinant	Treatment of Income	Provisions to be made
Substandard.	Where mark- up/ interest or principal is overdue by 180 days or more from the due date.	Unrealized interest / profit / mark-up to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized interest / profit / mark-up 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 net 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 I-4.
Doubtful.	Where mark-up/ interest or principal is overdue by one year or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal net 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 I-4.
Loss	Where mark-up/ interest or principal is overdue by 18 months or more from the due date. Where Inland Trade Bills are not paid/ adjusted within 180 days of the due date.	As above.	Provision of 100% of the difference resulting from the outstanding balance of principal net 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 I-4.

ANNEXURE-I-4

Regulation R – 8: Classification of Assets and Provisioning Requirements
Uniform Criteria for Determining the Value of Pledged Stock, Plant & Machinery under Charge and Mortgaged Properties for Microenterprise and Agriculture & Livestock Loans

MFBs 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 requirements as tabulated below:

Category of Assets	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 periods prescribed above.

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, valuation shall not be more than 3 years old.

b) Valuations of properties valuing above Rs. 3.0 million 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 MFB/bank/ DFI/ NBFC has been issued by the MFB.

d) Assets having pari-passu charge shall be considered on proportionate basis.

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

f) The evaluator, while assigning any values to the pledged stock, plant and machinery under charge and mortgaged residential, commercial and industrial properties (land and building only), 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 FSV.

g) 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.

h) 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.

Any misuse of FSV benefit detected during regular/ special inspection of SBP shall attract strict punitive action under the relevant provisions of Microfinance Institutions Ordinance 2001. Further, SBP may also withdraw the benefit of FSV from the MFB found involved in its misuse.

Various categories of assets to be considered for valuation would be as under:

a) **Liquid Assets:**
Valuation of Liquid Assets shall be determined by the MFB itself and verified by the external auditors.

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 (including stock pledged under

Electronic Warehouse Receipt (EWR) as defined in Collateral Management Companies Regulations 2019 issued by the SECP), FSV 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 in favour of MFB 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 I-5

Regulation R – 8: Classification of Assets and Provisioning Requirements
Guidelines for Classification and Provisioning of General Loans

Category	Determinant	Treatment of Income	Provisioning to be made
Substandard	Where mark-up/ interest or principal is overdue by 90 days or more from the due date.	Unrealized interest / profit / mark-up to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized interest / profit / mark-up already taken to income account to be reversed and kept in Memorandum Account.	25% of outstanding principal net of liquid assets realizable without recourse to a court of law.
Loss	Where mark-up/interest or principal is overdue by 180 days or more from the due date.	As above.	100% of outstanding principal net of liquid assets realizable without recourse to a court of law.

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