Frequently Asked Questions (FAQs) regarding Prudential Regulations of Corporate/Commercial Banking

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Definitions:

i. **While identifying 'Group', will the shareholding in Government-owned entities/financial institutions or vice-versa, form the 'Group'?**

No, the shareholding in or by the Government-owned entities and financial institutions does not form a 'Group'.

ii. **If a person is director on the board of more than one company, will such companies together be treated as Group on the basis of such 'Common Directorship'?**

No, Group will not be formed just on the basis of Common Directorship. For the purpose of Prudential Regulations, a group will comprise all persons, whether natural or juridical, if one of them or his dependent family members or its subsidiary, have control or hold substantial ownership interest (as defined in the regulations) over the other.

iii. **Does an affiliation arising on the basis of Nominee Director appointed by a Federal/Provincial Government constitute the 'Related Party'?**

No, a relationship that is based on the Nominee Director of Government will be excluded from the definition of 'Related Party'. However, the definition will include personal/family business interests of such nominee director.

iv. **Are the facilities extended against the security of Trust Receipt only be treated as 'Secured' exposure?**

Yes, a bank's exposure against the security of Trust Receipt only may be treated as secured exposure. However, the banks are free to take collateral/securities, to secure their risks/exposure, in addition to the Trust Receipt.

v. **Can the guarantees received as collateral from a commercial Bank/DFI/NBFC and Foreign bank be treated at par with 'Liquid Assets'?**

- Guarantees issued by domestic banks/DFIs (regardless of their rating) when received as collateral by banks/DFIs will be treated at par with liquid assets.
- A guarantee received from a foreign bank(not licensed by State Bank of Pakistan) will be treated as liquid asset only if the foreign bank have a minimum "A" rating assigned by Standard & Poors, Moody's, Fitch-IBCA, or Japan Credit Rating Agency (JCRA). Guarantees received from local NBFCs are not treated at par with liquid assets. However, banks/DFIs' exposure to an obligor/borrower against the Guarantee of a NBFC would be considered as secured, subject to compliance with Regulation R-9.

vi. **Does the definition of 'Exposure' also include bills purchased/discounted by the banks/DFIs?**

Yes, the definition of exposure also includes bills purchased/ discounted. However, bills purchased/discounted from borrower, drawn against the LCs, may be treated/exempted as per the provisions of Regulation R-1 (Annexure-I) and Regulation R-4 of Corporate/Commercial Banking.

vii. Can the revaluation reserve/surplus on fixed assets be counted in the 'Equity of the bank/DFI' for calculating limits/benchmarks under all Regulations of Corporate/Commercial Banking?

No, the benefit of surplus on revaluation of fixed assets (up to 50% of the amount) will be counted towards the equity only for the purpose of Regulation R-1 (i.e. Exposure Limits).

viii. Does the pledged goods (as collateral) also form part of the Liquid Assets?

No, pledged assets are not categorized as liquid assets. However, for the purpose of term 'Secured', these assets are categorized as a security. *(Pledged stock is also eligible for taking FSV benefit for provisioning Under PR R-8).*

ix. Can a bank/DFI extend credit facilities against the lien on COIs / Deposits maintained with NBFCs?

Yes, as defined in the Regulations, COIs/Deposits of NBFCs/DFIs rated "A" and above can be treated as liquid securities and loans can be extended against them (subject to the requirement that these assets are under perfect lien of the lending bank/DFI with appropriate margin).

1. Risk Management:

Regulation R-1(Exposure Limits):

i. Does revaluation reserve also include revaluation of assets other than fixed assets for the purpose of calculating single obligor/group exposure limits of the bank/DFI?

No, for the purpose of calculating single obligor/group exposure limits revaluation reserves will not include appreciation on account of assets other than fixed assets.

ii. **Does the group exposure limit cover exposure on Corporate and SMEs, owned by the same group, or, exposure taken on them is calculated separately?**

Yes, the group exposure limit will be calculated by taking financing facilities given to both Corporate and SMEs belonging to the same group.

iii. **Can a bank place an overall limit on its inter-bank placements for all the banks?**

Under Para No. 1(G) of Annexure-I of Prudential Regulation R-1 for Corporate/Commercial Banking, Banks/DFIs are explicitly required to ensure that the overall limit for each financial institution in respect of inter-bank placements is invariably approved by their Board of Directors. Thus, the sum of all these limits (for each financial institution) will become the overall limit for all banks in respect of interbank placements.

iv. **Does the exposure in respect of banks/DFIs' financing facilities calculated under Regulation R-1 mean the sanctioned limit or the outstanding amount?**

For the purpose of calculating exposure in respect of financing facilities, the sanctioned limits, or outstanding, whichever is higher, will be considered. However, in case of fully drawn term loans where there is no scope for re-drawal of any portion of the sanctioned limit, bank/DFI may consider the outstanding as exposure.

v. **Would investments (more than 5% of the equity of banks/DFIs) made by international bodies like World Bank, IFC etc. make them fall under the definition of related party in the context of exposure limits under Para No. 2 of PR R-1 of Corporate/Commercial Banking?**

Relationships arising from investments of international multilateral agencies like IFC, ADB and Islamic Development Bank etc (e.g. more than 5% shareholding in banks/DFIs vis-à-vis in other entities) would not fall under the definition of related party for the purpose of exposure limits under Para No. 2 of PR R-1 of Corporate/Commercial Banking.

vi. **While calculating Single Obligor/Obligor Group exposure limit under Regulation R-1 (Para 1, Para 2 and Annexure-I), is there any weightage (haircut/adjustment) available for exposure on NBFCs?**

No; as per Regulation R-1 (Para 1, Para 2 and Annexure-I) no weightage is available against exposure taken on the NBFCs. Such exposure will be taken at its entire value for the purpose of Regulation R-1.

vii. **Does the Single Obligor/Obligor Group exposure limit under PR R-1 apply on interbank placement with banks and DFIs?**

Yes, the interbank placement is also subject to Single Obligor limits under Regulation R-1. However, for calculating the Single Obligor Limit in such cases, the following adjustment weightages may be applied (as explained in Para 1-(G) of Annexure-I):

- 25% weightage on exposure to banks / DFIs with 'AAA' rating,
- 50% weightage on exposure to banks / DFIs rated 'A' and 'AA',
- 100% weightage on exposure to banks / DFIs rated below 'A',

Further, the banks/DFIs are required to ensure that the overall limit for each financial institution in respect of interbank placements is invariably approved by their Board of Directors.

viii. **Does Standby Letter of Credit (SBLC) have any weightage (haircut/adjustment) as normal LCs while calculating per party limit under PR R-1?**

No, Since a SBLC is a type of financial guarantee, no weightage (haircut/adjustment) or conversion factor under Annexure-I is allowed for calculating the exposure limits.

ix. **Are the facilities under Long Term Financing Facility for Plant and Machinery exempt from the Single Obligor limit under R-1?**

No, in arriving at exposure under Regulation R-1, weightage of 25% shall be given in respect of the Long Term Financing Facility for import of Plant & Machinery.

<u>Regulation R-2(Limit on Exposure against Contingent Liabilities):</u>

i. **A 50% weightage is available for LCs while calculating the bank's/DFI's 'Single Obligor Limit' under Regulation R-1. Is any such weightage (on LC) also available while calculating the Bank's/DFI's 'aggregate exposure limit' in respect of contingent liabilities under Regulation R-2?**

No, while calculating the 'aggregate exposure limit' of a bank/DFI in contingent liabilities under Regulation R-2, such weightage is not available against L/Cs. However, non fund based exposure to the extent covered by cash /liquid assets would not constitute contingent liability for the purpose of PR R-2 of Corporate/Commercial Banking.

<u>Regulation R-3(Financial Analysis):</u>

i. **Can the condition of obtaining CIB Report and BBFS be waived when a loan is fully secured by liquid assets?**

No, the condition of obtaining CIB Report and BBFS cannot be waived even if the loan is fully secured by Liquid Assets. However, if the Loan Application Form already contains all the information as required in BBFS, then no separate BBFS may be required.

ii. **Can a bank/DFI allow lending to the borrowers with CIB showing default?**

The banks/DFIs may allow financing to defaulters keeping in view their risk management policies and credit approval criteria, and that they properly record reasons and justifications in the approval form.

iii. Can a bank take exposure (Fresh/Renewal) on a borrower if any of the group companies has an overdue exposure in eCIB?

While considering any exposure (including renewal, enhancement and rescheduling/restructuring etc) to a borrower, banks are not only required to give due weightage to the credit report relating to the borrower but also those of the group companies. However, if the banks/DFIs decide to take exposure on defaulters, they should strictly follow their risk management policies and credit approval criteria and properly record reasons and justifications of the same in the approval form.

iv. Is the requirement of CIB report and Borrower Basic Fact Sheet applicable in case of placement with financial institutions (banks/DFIs/NBFCs)?

BBFS and CIB are not required in case of placements with financial institutions (banks/DFIs/NBFCs).

v. In respect of the financial conditions of borrower/obligor (e.g. current ratio, debt-equity ratio etc.), is there any mandatory minimum standards that banks/DFIs should observe before granting the financing facilities?

No, the State Bank has not prescribed any minimum financial ratios for the obligor/borrower. However, Regulation R-3 requires the banks/DFIs to have duly approved, effective credit policy in place which, inter alia, prescribes the minimum current ratio, linkage between borrower's equity and total financing facilities. Moreover, the banks/DFIs are required to obtain financial statements, CIB report, and basic facts of the borrower; and carry out the due assessment of its financial condition and financing needs before granting any new financing facility or renewal, enhancement, rescheduling etc. of the facility.

vi. As the requirement of Personal Guarantee is at bank's discretion, Is it necessary to report the net worth of Directors (who have given Personal guarantee to secure credit) as required in BBFS (Borrower's Basic Fact Sheet)?

Banks/DFIs are required to obtain duly filled in Borrower's Basic Fact Sheet while ensuring that all relevant details have been properly provided by the borrower(s) in the Borrower's Basic Fact Sheet.

vii. What should be the frequency and timeline for obtaining the audited financial statements?

At the time of allowing any exposure (including renewal, enhancement and rescheduling /restructuring) and annual review of long term facilities, Banks/DFIs are required to obtain copy of latest financial statements relating to the business of every borrower. Where finalization/audit of the financial statements of a public limited company is pending due to some judicial/statutory exigency, the bank/DFI may use last available audited financial statements together with management accounts of the borrower. However, upon the finalization of financial statements, bank should make due assessment of the same.

Regulation R-4(Security and Margin Requirements):

i. **Can a loan be secured against the pledge of stocks in transit?**

The level of risks associated with such type of security is relatively high. However, if terms of the documents of collateral entitle the bank to enforce/realize the value of its security in case of default or loss, the loan may be treated as secured. However, special care and prudence is required while extending any exposure against such collateral.

ii. **Does PR R-4 of Corporate/Commercial Banking prescribe any margin requirements on facilities provided by them to their clients?**

As per PR R-4 of Corporate/Commercial Banking, Banks/DFIs are free to determine the margin requirements on facilities provided by them taking into account the risk profile of the borrower(s). However, in cases where margin has been prescribed by State Bank/Government of Pakistan, appropriate margin shall at least be equal to the prescribed margin.

iii. **Do weightages (adjustments/haircuts) as given in Annexure-I of Regulation R-1 apply to interbank placements for the purpose of calculating clean exposure limits under Regulation R-4?**

Yes, the weightages (adjustments/haircuts) of Annexure-I will be available for calculating the permissible clean exposure limits (per party and aggregate clean exposure) under Regulation R-4.

iv. **Does the aggregate clean exposure limit include all the funded and non-funded clean exposure of the bank?**

Yes, while calculating the overall clean exposure limit, all the funded and non-funded exposure of the bank would be included except for the cases mentioned in Para (d) of PR R-4 of Corporate/Commercial Banking.

v. **Are clean inter-bank placements exempt from aggregate clean exposure limit under PR R-4?**

No, inter-bank placements are not altogether exempt from aggregate clean exposure limit under PR R-4.

vi. **Does adjustment weightages as given in Annexure –I of regulation R-1 apply to interbank placements for the purpose of calculating clean exposure limits under regulation R-4?**

Yes, the adjustment weightages of Annexure-I will be available for calculating the permissible clean exposure limits (Single Obligor and aggregate clean exposure) under regulation R-4.

vii. **Does the "aggregate clean exposure", mentioned in Regulation R-4 also include investment in shares, commercial papers and unsecured PTCs/TFCs?**

The Aggregate Clean exposure does not include investments in shares and commercial papers. However, investment in unsecured PTCs and TFCs (excluding those issued by banks/DFIs to raise Tier-II Capital as per SBP instructions) are included in the aggregate clean exposure.

Regulation R-5 (Monitoring):

i. Are the banks/DFIs required to institute mechanism for ensuring the proper utilization of both non-fund and fund-based financing?

Yes, in terms of Para 1 (c) of the Regulation R-5, banks/DFIs are required to devise an appropriate mechanism to ensure both fund and non-fund based financing provided are utilized for the intended purpose. Banks/DFIs are required to ensure that financing is not used for non productive purpose like hoarding, speculation etc.

Regulation R-6 (Exposure in Shares/TFCs/Sukuks):

i. If a bank has to take up the shares of any company due to underwriting commitments and such act causes the bank's holding to exceed 5% of paid-up shares in the subject company, will that company be considered as Related Party of the bank/DFI for the purpose of Para 2 of Regulation R-1 of Prudential Regulations of Corporate/Commercial Banking?

If a bank has to take up shares of any company due to underwriting commitments and such act causes the bank to hold 5% or more shareholding in the subject company, it will not be considered as "Related Party" for the purpose of Para 2 of Regulation R-1 of PRs. However, in the event of inability of the bank to off-load shares acquired in underwriting commitment within the period of 18 months, the subject company will be treated as related party for the purpose of Para 2 of Regulation R-1 of PRs.

ii. Are the per scrip exposure limit prescribed under PR R-6 1(A) of Corporate/Commercial Banking applicable to strategic investment and investments in units of all forms of mutual funds/REITS or the same would be counted towards the aggregate investment limit only?

The limits mentioned under PR R-6 1(A) of Corporate/Commercial Banking are also applicable to strategic investments and investments in units of all forms of Mutual Funds/REITs excluding NIT units till its privatization.

iii. Can the purchase of shares in the ready or future market (long position) and its sale towards the future (short position) be netted off for the purpose of calculation of maximum exposure in futures i.e. 10% of bank's equity?

The purchase of shares in the ready or future market and its sale towards the future can not be netted off for the purpose of calculation of maximum exposure in futures i.e. 10% of bank's equity since the Regulation R-6 provides for inclusion of the positions both in the buying (long) and selling (short).

iv. Will banks/DFIs' aggregate investment in units of REIT be counted towards the aggregate investment limits of 30% of equity of the banks prescribed in the Regulation R-6 of Prudential Regulations for Corporate/Commercial Banking?

Banks/DFIs' investment in units of REIT shall not be counted towards the aggregate investment limits of 30% and 35% of equity of the banks and Islamic banks/DFIs respectively, prescribed in the Regulation R-6 of Prudential Regulations for Corporate/Commercial Banking. Instead, aggregate investment in units of REITs shall be 10% of the equity of the bank/DFI.

v. Will banks/DFIs investments in its subsidiaries subject to the investment limits prescribed under PR R-6 of Corporate/Commercial Banking?

Investments of the bank/DFI in its subsidiary companies (listed as well as non-listed) shall not be included in the limits prescribed under PR R-6 of Corporate/Commercial Banking. However, the single obligor exposure limit under PR R-1 of Prudential Regulations for Corporate/Commercial Banking will be applicable on exposure to the subsidiary and any type of placement in the form of deposit, purchase of COI, certificates, etc. shall be considered part of the exposure of the Bank/DFI. Further, the exposure of the Bank/DFI on mutual funds launched/administered by the subsidiary shall also be considered exposure on the subsidiary.

vi. Do Prudential Regulations of Corporate/Commercial Banking prescribe any limit in respect of Banks/DFIs' total exposure in equity market (equity investment, margin financing, repo/reverse repo transaction and financing against shares)?

As per BPRD Circular No. 3 of 2008, the total exposure of banks/DFIs in shares whether in equity investment, margin financing, repo/reverse repo transaction and financing against shares, etc at any given point of time, should not exceed 50% of the equity of the Bank/DFI and subject to compliance of limits laid down in Regulation R-6 of Prudential Regulations for Corporate/Commercial Banking. Financing to asset management companies, and their mutual funds shall also be counted towards the aforesaid limit.

vii. Would the seed capital as well as incremental investment in the subsidiary companies be exempt from the capping requirement of regulatory limits under PR R-6 of Corporate/Commercial Banking?

Yes, the seed capital as well as incremental investment in the subsidiary companies will be exempt for the purpose of calculating aggregate investment limit of 30%.

viii. Does PR R-6 prescribe any investment limits in respect of banks/DFIs' investment in Real Estate Sector?

Under PR R-6 of Corporate/Commercial Banking, Banks/DFIs are required not to own units of a REIT (Real Estate Investments Trust) in excess of 5% of their own equity. Furthermore, Aggregate investment limit in units of REIT is required to be not more than 10% of equity of the bank/DFI, exclusive of the aggregate limit prescribed under PR R-6 of Corporate/Commercial Banking. As regards the aggregate exposure in Real Estate Sector, Banks/DFIs are required to follow the instructions of BPRD Circulars No.1 and 02 of 2014.

ix. Do Banks/DFIs have to seek permission regarding disposal of strategic investments?

Banks/DFIs may dispose of strategic investments after retaining the same for the minimum period prescribed under BPRD Circular Letter No 16 dated August 1, 2006.

x. Can a bank take exposure against the security of mutual funds managed by the subsidiary of the borrower?

In terms of Para No.5 (d) of PR R-6 of Corporate/Commercial Banking, the bank cannot take exposure (fund based and non fund based) against the security of mutual fund units managed by a borrower's group companies.

xi. Is Para No. 5 of PR R-6 of Corporate/Commercial Banking applicable in case of financing against mutual funds as collateral/security?

Yes, Financing against mutual funds as collaterals is also subject to restrictions mentioned under Para No. 5 of PR R-6 of Corporate/Commercial Banking.

xii. Whether the 30% limit on banks/DFIs total investment in shares includes both listed and un-listed shares (ordinary and preference)?

Yes, the 30% limit includes both listed and non-listed (ordinary and preference shares). However, only those preference shares will attract the 30% capping requirement which fulfill the criteria of equity instrument as laid down in Annexure-III of PR R-6 of Corporate/Commercial Banking. Any investment in preference shares that do not conform to these conditions shall instead be considered as part of the maximum exposure limit as prescribed under R-1 of these regulations.

xiii. Is the bank's investment in Margin Financing subject to the usual margin requirements of 30%?

Yes, the Margin Financing is subject to 30% margin requirement (please refer Regulation R-4).

xiv. Are all forms of mutual funds treated at par with shares while calculating the banks/DFIs' investments under PR R-6 of Corporate/Commercial Banking?

Yes, the limits prescribed under PR R-6 1(A) of Corporate/Commercial banking are applicable to investments in units of all forms of Mutual Funds excluding NIT units.

xv. Is the Investment of banks/DFIs in COIs with NBFCs, considered clean?

Certificates of Investment (COIs) issued by NBFCs rated at least 'A' by a credit rating agency on the approved panel of State Bank of Pakistan are treated as liquid assets and hence secured. Furthermore, Investment in COIs / interbank placements with NBFCs at least rated 'A' for long-term rating and 'A2' for short-term rating or equivalent by a recognized rating agency, are exempted from aggregate limits for unsecured/clean exposure.

xvi. Can a bank/DFI make direct investment in or allow financing facilities against the unsecured/ unlisted/un-rated TFCs?

- A bank/DFI cannot take exposure against unsecured, non-listed and non-rated TFCs or TFCs rated below 'BBB' or equivalent. Exposure may, however, be taken against unsecured/subordinated TFCs, which are issued by the banks/DFIs for meeting their minimum capital requirements, as per terms and conditions stipulated in BSD Circular No. 8 of June 27, 2006 and BPRD Circular No. 06 of August 15, 2013.

- Banks/DFIs may make direct investment in non-listed TFCs, subject to compliance with other Regulations.

xvii. Are such mutual funds which invest in Government Securities exempt from exposure limits under Regulation R-6?

No, mutual funds comprising investments in T-bills and PIBs etc are not exempted from exposure in the applicable exposure limit.

xviii. Is there any criterion for categorizing banks/DFIs' investment in hybrid instruments (i.e. preference shares) into debt or equity investment?

The detailed criterion is given in Annexure-III of PR R-6 of Corporate/Commercial Banking.

xix. Can the provisions, held against permanent impairment in the value of investment in shares, be deducted from the cost of acquisition to arrive at exposure limit?

Yes, the amount of provisions created by debiting the Profit & Loss account for the permanent impairment in the value of shares, as instructed vide BSD Circular No. 10 dated July 13, 2004, may be deducted from the cost of acquisition of such investments to arrive at the exposure limit.

xx. Can a bank provide financing to individual against shares of a company in which he himself is a shareholder and/or director?

Regulation R-6(Para No.5(d) as such does not restrict financing to an individual against the shares of a company, other than a banking company, in which he/she is a director/shareholder, provided that such company is not a group company (as defined in the PRs) of the person.

xxi. Does the exposure in Margin Financing or financing against the security of shares form part of the share portfolio for the purpose of calculating the exposure limits under Regulation R-6?

No, the Margin Financing or financing against the security of shares are not treated as part of the shares portfolio of the banks/DFIs for the purpose of calculating investment limits under Regulation R-6. However, exposure under Margin Financing will be treated as part of the total exposure while calculating the Single Obligor funded exposure limit under Regulation R-1 and BPRD Circular No. 3 of 2008.

xxii. Is Para No. 5 of Regulation R-6 applicable in case of financing against mutual funds as collateral/security?

Yes, financing against the security/collateral of mutual funds is also subject to restrictions mentioned under Para No. 5 of Regulation R-6.

Regulation R-7(Guarantees):

i. Are all Guarantees issued by banks/DFIs required to be fully secured?

All guarantees issued by the banks/DFIs are required to be fully secured, except in the cases mentioned below where it may be waived up to 50% by the banks/DFIs at their own discretion, provided that banks/DFIs hold at least 20% of the guaranteed amount in the form of liquid assets as security:

i. For bid bonds issued on behalf of local consultancy firms/ contractors of goods and services bidding for international contracts/Tenders where the consultancy fees and other payments are to be received in foreign exchange.
ii. For issue of performance bonds on behalf of local construction companies/ contractors of goods and services bidding for international tenders.
iii. For issue of guarantees on behalf of local construction companies/ contractors of goods and services bidding for international tenders in respect of mobilization advance.

ii. Can the banks/DFIs issue open-ended Guarantees?

Banks/DFIs are allowed to issue open-ended guarantees provided banks/DFIs have secured their interest by adequate collateral or other arrangements acceptable to the bank/DFI for issuance of such guarantees in favour of Government departments, corporations/autonomous bodies owned/controlled by the Government and guarantees required by the courts.

iii. Does PR R-7 of Corporate/Commercial Banking prescribe any limit in respect of amount of Guarantees to be issued against the counter guarantees as detailed in PR R-7 of Corporate/Commercial Banking?

Banks/DFIs are required to have a board approved policy having internal limits for acceptance of counter guarantees based on, interalia, their own risk appetite and risk profile of the counter-guarantee issuing bank. The Banks/DFIs are required to institute a mechanism to monitor such limits.

Regulation R-8(Classification and Provisioning):

i. In how many ways can a loan be classified?

PR R-8 of Corporate/Commercial Banking prescribes two criteria for classifying a loan. Objective criteria requires classification based on time frame of delinquency/default in the payment of markup or principal as detailed in Annexure-V of PR R-8. Apart from objective criteria, subjective criteria is also used for classification of a loan, which may besides other factors include cash flow patterns of the borrower, adequacy of his security inclusive of its realizable value, documentation covering the advances and other market conditions relevant for the particular business of the borrower etc.

ii. Under what conditions the category of classification may be changed or the account may be declassified after rescheduling/restructuring?

If a loan has been rescheduled/restructured then the category of classification may be changed under following circumstances:

i. The borrower has adjusted at least 10% of the total restructured loan amount in cash and the terms and conditions of rescheduling/restructuring are fully met for a period of at least one year (excluding grace period) from date of rescheduling/restructuring.

ii. The borrower has adjusted at least 35% of the total restructured loan amount in cash at the time of restructuring agreement or later-on during the grace period, if any.

iii. PR R-8 of Corporate/Commercial Banking stipulates that the status of classification of an account which has been rescheduled/restructured can be changed if 35% of the amount is recovered in Cash without retaining it in the classified category for one year. Is the said exemption also subject to meeting the other terms and conditions of rescheduling/restructuring?

No, if the borrower has adjusted at least 35% of the total restructured loan amount at the time of restructuring agreement or later-on during the grace period if any, then the status of classification of account which has been rescheduled/restructured may be changed without retaining it in the classified category for one year. However, if the borrower subsequently defaults then the loan would be classified in the same category as it was in at the time of classification.

iv. If rescheduled/restructured loan/account has been declassified after remaining in the classified category based on improved performance of the borrower/after fulfilling the terms and conditions of restructuring/ rescheduling by the borrower, and if the borrower subsequently defaults then which category of classification would be used?

If a borrower subsequently defaults after the rescheduled/restructured loan has been declassified by the bank/DFI, the loan will again be classified in the same category as it was in at the time of rescheduling and restructuring.

v. Can category of classification of a non performing loan determined on the basis of time based criteria be further downgraded?

Yes, category of classification determined on the basis of time based criteria can be further downgraded based of subjective evaluation of the non-performing loan. Such evaluation shall be carried out on the basis of credit worthiness of the borrower, its cash flow, operation in account and adequacy of security etc.

vi. Would deferment of installment or mark-up in respect of a credit facility be considered as rescheduling?

Mere deferment of a single installment or mark-up does not mean rescheduling unless it does not go to such extent where the original schedule of payment is altered or changed due to such deferment.

vii. Can a rescheduled/restructured loan be reported as "overdue" in the CIB Reports submitted to the State Bank of Pakistan?

While reporting to the Credit Information Bureau (CIB) of State Bank of Pakistan, such loans/advances may be shown as 'rescheduled/restructured' instead of 'overdue'.

viii. Under What conditions the category of classification may be changed or the account be declassified if the loan has not been rescheduled/restructured?

A classified loan account which has not been restructured/rescheduled, can only be declassified, if the borrower clears up the 100% overdue principal and mark-up.

ix. Can a bank/DFI reverse the provision already held against restructured/rescheduled account before or after its declassification?

In case of restructured/rescheduled accounts, the bank/DFI may reverse the provision already held to the extent of cash recovery, subject to the condition that the remaining outstanding should be provided to the extent as required by the category of classification in which the restructured/ rescheduled loan actually appears, till the time of declassification of the loan account. After declassification of the restructured/ rescheduled account as per criteria laid down in Regulation R-8, the bank/DFI may reverse the available provision up to 100% of its value if the bank/DFI deems such reversal advisable.

x. Can a bank/DFI reverse the unrealized markup lying in suspense account accrued on a restructured/rescheduled account before or after declassification?

A bank/DFI cannot reverse (take to income account) the unrealized mark-up lying in Suspense Account accrued on a restructured/rescheduled account till its declassification, except the portion of suspended mark-up which is realized by the bank/DFI in cash. Whereas, after declassification of the restructured/rescheduled account, the suspended mark-up may be reversed by the bank/DFI, provided at least 50% of the total suspended mark-up is recovered by the bank/DFI.

xi. In how many ways can a loan be declassified under PR R-8 of Corporate/Commercial Banking?

A loan may be declassified in the following ways:

i. If the bank has received overdue principal and mark-up on a restructured/rescheduled account, then such loan will be declassified after meeting all conditions as stipulated in Para 3(a) of Prudential Regulation R-8 of Corporate and Commercial Banking.
ii. If the account is not a restructured/rescheduled one, then recovery of 100% overdue principal and mark-up may justify its declassification.

iii. The accounts classified on advice of SBP will not be declassified without prior approval of SBP except in cases where cash recovery has been made through customer's own sources, to the extent that balance provision is maintained in accordance with the PR R-8.

xii. Will a fresh finance, allowed to a company at the time of restructuring/rescheduling of an old loan, also be classified in the category as the old restructured/rescheduled loan appears?

The fresh loan granted in such case may be monitored separately and will be subject to classification on the strength of its own specific terms and conditions.

xiii. If the evaluators are not allowed to enter the premises for conducting full-scope evaluation, then such evaluation (forced-sale value) may qualify for provisioning benefit?

In cases where evaluators are not allowed by the borrowers to enter in their premises/or the circumstances warrant inaccessibility to the premises, the full-scope evaluation, conducted as such, will not be accepted for provisioning benefit.

xiv. What is the valuation process for the purpose of assessing the forced sale value (FSV) of the eligible securities for provisioning benefit?

The banks/DFIs will be required to get a Full Scope Valuation once in three years. After the Full Scope Valuation, the banks/DFIs will get two 'Desktop Valuations' in the next two years.

xv. What is the difference between full-scope valuation and Desk-top valuation?

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

xvi. Does PR R-8 of Corporate/Commercial Banking prescribe any criteria regarding the "evaluators" conducting the valuations of the assets?

Yes, all Full scope Valuations are required to be carried out by the independent evaluators listed on the panel of evaluators maintained by Pakistan Banks Association (PBA). In case the loan amount exceeds Rs 100 million, the valuations (both Full-Scope as well as Desk-top Valuation) of the assets shall be carried out by the same evaluator (who is on the panel of PBA). However, for loan amount less than Rs 100 million, banks/DFIs or the approved evaluator may conduct the desktop valuation.

xvii. Full-scope valuation of assets is valid for three years. Is that timeline also applicable to valuation of pledged stock of perishable and non-perishable goods?

Under PR R-8 of Corporate/Commercial Banking, the valuation of pledged stocks of perishable and non-perishable goods should not be more than six months old at each balance sheet date. In case of perishable goods, the evaluator should also give the approximate date of complete erosion of value.

xviii. What assets shall be considered for taking FSV benefit for provisioning requirement under PR R-8 of Corporate/Commercial Banking?

Liquid assets, pledged stock, plant and machinery under charge, property having registered or equitable mortgage shall be considered for taking benefit for provisioning. Pledged shares which are in dematerialized form in CDC would be considered for deduction as liquid assets while determining required provisions.

xix. What assets shall not be considered for taking FSV benefit for provisioning requirement under PR R-8 of Corporate/Commercial Banking?

Hypothecated assets excluding plant and machinery under charge, assets with second charge and floating charge shall not be considered for taking benefit for provisioning.

xx. Under PR R-8 of Corporate/Commercial Banking, whether the bonus to employees arising from availing the benefit of Forced Sale Value (FSV) is referred to shares/stock bonus or annual employees' performance bonus?

The term bonus refers to bonus to employees in any form whether it is in the form of stock or in form of cash. Therefore, any benefit to employees is not admissible on account of additional impact on profitability arising from availing the benefit of FSV as allowed under the Regulation R-8 of Corporate/Commercial Banking.

<u>Regulation R-9(Assuming Obligations on behalf of NBFCs):</u>

i. Can the banks/DFIs take exposure on Single Obligor/Obligor Group against the Guarantee of NBFC?

Yes, Banks/DFIs may take exposure on Single Obligor/Obligor Group against the Guarantee of NBFCs subject to following conditions:

i. The NBFC is rated at least "A" or equivalent by a credit Rating Agency on the approved panel of SBP.
ii. Aggregate Exposure remains within the Single Obligor/Obligor Group limits prescribed under PR R-1 of Corporate/Commercial Banking.
iii. Total Guarantees issued by NBFC in favor of banks/DFIs does not exceed 2.5 times of the capital of the NBFC.

ii. Will banks/DFIs' exposure on any obligor against the Guarantee of an NBFC be considered as secured?

Yes, Banks/DFIs' exposure to any obligor against the Guarantee of an NBFC would be considered as secured provided the banks/DFIs meet the criteria prescribed under PR R-9 of Corporate/Commercial Banking before taking any exposure.

iii. **Can the banks/DFIs issue underwriting commitments in respect of TFCs, commercial papers and other debt instruments issued by NBFCs?**

Yes, the banks/DFIs can issue underwriting commitments in respect of TFCs, commercial papers and other debt instruments issued by NBFCs.

Regulation R-10 (Payment of Dividend):

i. **PR R-10 of Corporate/Commercial Banking stipulates that banks/DFIs, interalia can pay the dividend on their shares only if all the classified assets have been fully and duly provided for in accordance with PRs (taking the FSV benefit etc). However, PR R-8 stipulates that banks/DFIs may avail the FSV benefit subject to the condition that profitability arising from FSV benefit shall not be available for payment of cash /stock dividend, isn't it a contradiction?**

No, PR R-10 of Corporate/Commercial Banking, interalia, prohibits paying of dividend on their shares unless all the classified assets have been fully provided for taking into account FSV benefit etc. However, the additional impact on the profitability arising due to FSV benefit availed in respect of the classified assets is not eligible for payment of dividend on their shares under PR R-8 of Corporate/Commercial Banking.

2. Corporate Governance:

i. **How to calculate 7 days within which FPT is required to be submitted to SBP?**

It simply goes by counting 7 consecutive calendar days in a row. It should not be construed as 7 working days.

ii. **What about submission of FPT documents of those executives who are not Group Heads as such but are directly reporting to CEO?**

As per new instructions (BPRD Circular No 5 of 2015), executives directly reporting to CEO and/or COO shall also be considered as Key Executives and their FPT documents need to be submitted to SBP in case of fresh appointment/reappointment.

iii. **Does Annexure-IV(Corporate Governance Annexure) (undertaking) by a bank for an appointee require to be submitted on a stamp paper?**

No it does not specifically require non-judicial stamp paper for submission of an Annexure-IV (undertaking).

iv. **Can a key executive hold charge of 2 posts at the same time?**

As per PR G-1, no key executive shall head more than one functional area. In peculiar circumstances, He may hold an additional charge of another key post but the same needs to be regularized within 3 months.

v. **Can a key executive hold directorship with any other financial institution in personal capacity?**

No, he cannot unless he is nominated by his bank.

vi. **Can a director hold multiple directorships with more than one bank at the same time?**

No, he cannot in light of PR G-1 and Section 20 of BCO except NIT Nominees.

vii. **Can CEO hold directorship with any other bank?**

CEO is also a deemed director. If he holds directorship with any other bank the same will be seen as dual/common directorship which is prohibited under Section 20 of BCO and PR G-1 of Corporate/Commercial Banking.

viii. **How to comply with the requirements of SECP's Code of Corporate Governance when SBP's FPT Criteria is already in place?**

In terms of PR G-1 of Corporate/Commercial Banking, Code is applicable to the banks up to the extent it is not contrary to the provisions of BCO and PRs (FPT Criteria & other instructions).

ix. **How many independent directors are required for a Board having nine or seven board members to comply with the requirement of 25% independent directors?**

This can be determined on the basis of rounding off to the nearest tenth decimal place. For example, if 25% of 7 directors comes to 1.75, after rounding off, the bank should have 2 independent directors. Similarly, 25% of 9 directors comes to 2.25, therefore the bank should have at least 2 independent directors.

x. **Whether the minutes of Board Meeting of Banks/DFIs should be recorded by names?**

Yes, the Board Meeting minutes should be recorded by name in order to evaluate the performance and contribution of individual board members.

xi. Whether Incharge of Bank's Representative Office in other countries requires prior clearance from SBP?

Since, Incharge of Representative Office are not amongst the Overseas Executives/Key Executives as stipulated in BPRD Circular No. 5 of 2015, therefore the same do not require prior SBP clearance.

xii. Can the proposed board member whose FPT clearance is pending with SBP attend BoDs meeting?

No, board members cannot attend board meetings without SBP's prior approval.

xiii. What is the timeline of filling up the casual vacancy on the Board of Directors?

As per Code of Corporate Governance, casual vacancy on the Board of Directors shall be filled up by the directors at the earliest but not later than 90 days.

xiv. Can a director/chairman of the board of a company be given loan against the shares of that company?

Prudential Regulations do not place any restriction on a director or chairman willing to avail financing facility from some bank/DFI in their individual capacity, against the shares of the company (other than the bank/DFI) on whose board they hold the position of director or chairman.

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