APPENDIX – II TO BSD CIRCULAR No. 05
DATED 25th MARCH, 2003.

RULES RELATING TO UNSECURED SUB-ORDINATED DEBT INSTRUMENTS

1. Terms of Issue

To be eligible for inclusion in supplementary capital the terms of issue of the subordinated debt instruments should be in conformity with the following:

(i) Amount:

The amount of sub-ordinated debt to be raised may be decided by the Board of Directors of the Bank.

(ii) Maturity Period:

The sub-ordinated debt instruments should have a minimum original fixed term to maturity of over 5 years. For the purpose of counting the subordinated debt towards supplementary capital, during the last five years to maturity, a discount factor of 20 % per year will be applied as per following schedule. In case of staggered principal repayments, the outstanding amount included in supplementary capital must be discounted by 20% percent a year (20% of the original amount less any redemptions) during the last five years to maturity.

Remaining Maturity of the Instrument	Rate of Discount %
Less than one year	100
More than one year less than two years	80
More than two years less than three years	60
More than three years less than four years	40
More than four years and up to five years	20

(iii) Rating:

The instrument should be rated separately – Minimum rating required is 'A' or equivalent as given by a credit rating agency recognized by State Bank of Pakistan.

(iv) Rate of Profit:

The instruments should be 'vanila' with no special features like option of converting the TFCs into shares etc. Rate of profit shall be decided by the issuer.

(v) **Minimum Disclosure Requirements:**

The issuing bank must clearly disclose in the offer documents that the instrument is unsecured, sub-ordinated as to payment of principal and profit to all other indebtedness of the bank, including deposits and is not redeemable before maturity without prior approval of the SBP.

(vi) **Other conditions**

a. Sponsor shareholders of the issuing bank shall not be allowed to participate in or hold the sub-ordinated debt instruments of the issuing bank directly or through their affiliates. The same restriction will also apply to the employees' retirement benefit funds of the issuing bank

b. Banks should indicate the amount/details of subordinated debt raised as supplementary capital by way of explanatory notes in their annual audited accounts and Half Yearly Statement on Minimum Capital Requirements, submitted to State Bank.

2. Grant of advances against Subordinated Debt Instruments.

Banks should not grant advances against the security of their own sub-ordinated debt issue. While granting loans/advances against subordinated debt instruments of other banks, the margin requirement prescribed under PR-VI shall be maintained, however the bank's total financing against subordinated debt instruments issued by banks should not exceed its total equity (Tier-I capital). Further the bank shall not provide any accommodation to finance purchase of its subordinated debt instrument

3. Treatment of Investment in sub-ordinated debt instruments

Investment by banks in sub-ordinated debt instruments of other banks will be deducted from the holder's total equity (Tier-I capital) and will be assigned a risk weight of "0%" for capital adequacy purposes.

4. Other Requirements

a. The issuing banks should submit a report to State Bank of Pakistan giving details of the subordinated debt, such as amount raised, maturity of the instrument, rate of profit etc. within one month from the date of issue.

b. The proceeds of rupee denominated debt instruments offered/issued to non-residents would have to be repatriated to Pakistan and converted into rupees by the bank concerned and PRC would be furnished to SBP. The bank concerned will be allowed to remit the principal amount of debt instruments at maturity as well as the profit/interest thereon from the interbank market. Hedging will not be available on such instruments.

c. Banks should comply with all the terms and conditions, if any set out in any law in the country with regard to issue of the instruments.

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