



State Bank of Pakistan

Prudential Regulations for Small & Medium Enterprise Financing

SME, Housing & Sustainable Finance Department

(Issued on November 06, 2025)

The Team

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Preface

Small & Medium Enterprise (SME) sector contributes significantly towards national GDP, employment generation and export earnings. The potential of this sector to contribute to the economic development objectives of Pakistan, in areas like creating jobs, increasing incomes, improving competitiveness, boosting exports and fostering economic growth is the justification for a strategy of support to unleash the sector's potential. Keeping this in view, State Bank of Pakistan (SBP) issued separate Prudential Regulations (PRs) for Small and Medium Enterprise Financing in 2003, which were subsequently revised from time to time in line with the changing market dynamics.

A comprehensive revision of the SME PRs has been undertaken to institutionalize recent policy developments and promote sustainable, responsible, and inclusive SME finance in Pakistan. In addition to the introduction of new regulations, several existing PRs have also been revised. These revisions are aimed at making the PRs principles based, removing structural barriers in SME finance, encouraging banks/DFIs and to leverage technology, and fostering partnerships with fintechs and other non-financial service providers for scalable and sustainable SME financing. SBP expects all banks/DFIs to implement these regulations in letter and spirit and to play their role in unlocking the potential of Pakistan's dynamic SME sector.

For Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) Regulations and Corporate Governance, the Prudential Regulations and other instructions issued by Banking Policy & Regulations Department from time to time may be referred. However, in case of international operations, the prudential regulations of host country shall prevail.

Any violation or circumvention of these regulations shall render the bank/DFI officer(s) concerned liable for penal actions under the relevant laws.

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Dated: November 06, 2025

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Part-I: Definitions of Small and Medium Enterprises (SMEs)

For the purpose of these Prudential Regulations, Small and Medium Enterprises (SMEs) are defined as under:

Enterprise Category*	Criteria-Annual Sales Turnover
Small Enterprise (SE) a) Micro Enterprise b) Above Micro Enterprise	a) Up to PKR 30 Million b) Above PKR 30 Million to PKR 150 Million
Medium Enterprise (ME)	Above PKR 150 Million to PKR 800 Million
Start-up	A small enterprise or medium enterprise up to 5 years old will be considered as Start-up SE or Start-up ME

*An independent, for profit, privately owned enterprise.

Part-II: Regulations

Regulation R-1: SME Finance Strategy

Banks/DFIs shall own and develop SME finance as one of their key business lines and shall have a vision, plan and strategy duly approved by their respective Board of Directors (BODs) to develop and expand their SME finance portfolio on sustained basis. The Board approved SME finance strategy shall give the bank's/DFI's aspirations for the SMEs where it wants to see itself in the SME space. It shall inter alia include:

- i. Key SME sectors, subsectors, clusters, value chains etc. to be targeted
- ii. Next 5 years targets for growth in financing and the number of SME borrowers
- iii. The 5-year plan will be a moving plan with a new year's plan added each year with the approval of the Board
- iv. Financing techniques, instruments, products and services to cater to the financing needs of the SMEs
- v. Targeted strategies to promote financing to women-led enterprises
- vi. Products and services rollout and marketing strategies
- vii. Allocation of SME finance growth targets at the regional/zonal and Branch levels
- viii. Clear, explicit and lean reporting lines and credit approval mechanisms
- ix. Incentives structure for the Regional/Zonal Chiefs, Branch Managers, and SME business teams
- x. Plans to build and strengthen the SME finance capacity in terms of quality HR, increase in SME touch points, leveraging technology and improving product delivery systems etc.
- xi. Usage of income estimation models or other proxies to evaluate financial capacity of the SME applicants having limited credit history
- xii. Provision of non-financial advisory services to SMEs through partnerships with fintechs and other players providing such services to the SMEs.

Regulation R-2: SME Business Analysis Capacity

Banks/DFIs shall either develop their internal capacity or engage reputed business analyst firms for detailed and in depth analysis of various sectors, subsectors, clusters of SMEs being targeted by them to have better understanding and appreciation of the SMEs' business conditions and environment, opportunities, challenges, outlook, cash flow cycles, business practices and culture. The business analysis will be an ongoing exercise enabling the banks/DFIs to have their hand on the pulse of the targeted SMEs' sectors/subsectors. The banks/DFIs products and services for SMEs as well as the cash flows and risk assessment systems shall be based on the detailed information sets to be generated by the business analysis function.

Regulation R-3: SME Finance Function

Each bank/DFI shall have SME Finance Group/Department to be headed by a senior dedicated resource having excellent understanding of SMEs' business environment and at least 5 years' experience in SME finance. The Head SME will either report directly to the President/CEO or through a designated Group Head.

Regulation R-4: Management Committee on SME Finance

- i. To ensure effective governance and oversight of SME finance function, banks/DFIs shall establish a Management Committee on SME Finance Governance & Oversight. The Committee shall monitor the bank's/DFI's SME financing performance at least on quarterly basis against the SME finance strategy approved by Board and take corrective measures, if any needed to improve the performance and capacity of the bank/DFI. The Committee shall be chaired by President/Chief Executive Officer (CEO) of the bank/DFI, and shall include, Group Head SME Finance, Group Head Risk Management and any other senior executive as deemed appropriate by the President/CEO. The minutes of the Committee meetings shall be shared electronically with the SME, Housing & Sustainable Finance Department (SH&SFD), State Bank of Pakistan (SBP) within 30 days of the meeting.
- ii. The Board shall review the performance and achievement against the SME finance strategy at least on annual basis; the assessment shared with the Board shall also be shared with SH&SFD along with the Board observations, advice and guidance.

Regulation R-5: Per Party Exposure Limit

Small Enterprise (Micro & Above Micro Enterprises) can avail facilities (funded and non-funded) of up to PKR 100 million, and Medium Enterprise (ME) up to PKR 500 million from a single bank or from all banks/DFIs/MFBs. Banks/DFIs may deduct the liquid assets (encashment value of bank deposits, certificates of deposit/investment, Pakistan Investment Bonds, Treasury Bills and National Saving Scheme Securities) held under their perfected lien for the purpose of calculation of per party exposure limit.

Regulation R-6: Standardized Loan Application Form

Banks/DFIs shall adopt standardized and simplified loan application form circulated by Pakistan Banks' Association (PBA) and provide the SME borrowers with list of documents required for processing the loan application at the time of applying for the loan. In addition to the paper based application forms, the banks/DFIs shall provide digital forms¹ for applying for SME financing.

¹ Within 3 months of notification of these PRs

Regulation R-7: Credit Information

While considering any credit proposal (including renewal, enhancement and rescheduling/restructuring), banks/DFIs shall obtain latest credit information report on their prospective borrower(s) from Electronic Credit Information Bureau (e-CIB) of SBP or any Credit Information Bureau licensed/regulated by SBP. Banks/DFIs may take exposure against the SMEs with overdue portfolio based on their internal risk assessment policies; the reasons for allowing financing to such SMEs shall however be properly documented in the approval form.

Regulation R-8: Risk Management System

Within overall risk management function, banks/DFIs shall have robust risk management systems, infrastructure, and HR capacity to identify, assess and manage risks associated with SME financing. For this purpose, each bank/DFI shall have a senior dedicated resource, reporting directly to Risk Head for risk assessment of SME financing.

Regulation R-9: Limit on Clean Facility

Banks/DFIs can take clean exposure on SMEs (the cash flow-based facilities secured solely against personal guarantees) as determined by them based on the SME's cash flows strength, financial condition, credit worthiness, credit score etc. and risk appetite of the bank/DFI. However, the clean exposure against an SME shall not exceed PKR 50 million. Further, the clean exposure shall not include the clean consumer financing limits (Credit Card and Personal Loans etc.) allowed to a sponsor of the said SME under Prudential Regulations for Consumer Financing.

Regulation R-10: Loan/Financing Monitoring System

Banks/DFIs shall establish an effective loan/financing monitoring mechanism, leveraging technology and digital tools where feasible, to monitor operating and financial performance of the SMEs. For the purpose, banks/DFIs may deploy/use digital or physical verification and monitoring tools, monitor operations in the SME account(s) with the financing bank digital stock reports etc.

Regulation R-11: Restriction on Facilities to Related Parties

Banks/DFIs shall not take any exposure on an SME in which any of its directors, major shareholders holding 5% or more of the share capital of the bank/DFI or its Chief Executive, or any family member of these persons or related parties as defined in SBP Prudential Regulations for Corporate/Commercial Banking is interested, except as specifically allowed under any law.

Regulation R-12: Ensuring Adequate Disclosure of Loan/Financing Terms

Banks/DFIs shall ensure full disclosure of financial products and services at the time of financing. To ensure clear understanding of loan/financing terms and conditions, banks/DFIs shall provide the information in both English and Urdu languages through digital and/or physical means. Charge documents may remain in their original legal language, with banks/DFIs ensuring that borrowers are briefed on their key obligations.

Regulation R-13: Securities and Margin Requirements

All facilities except the clean financing to SMEs shall be appropriately secured as per the respective policy of the banks/DFIs. Banks/DFIs shall determine the margin requirements on securities obtained against SME finance facilities based on their respective policies to secure the loan/financing.

Regulation R-14: Digitalization of SME Finance and Digital Supply Chain Financing**a. Digitalization of SME Finance**

- i. Banks/DFIs shall facilitate end-to-end digital on-boarding of SME customers using the applicable regulations.
- ii. Information collected during account opening shall be reused across credit assessment processes, avoiding duplication of data collection and improving user experience.
- iii. Wherever statutory or regulatory data is available through authorized third-party sources, it shall not be collected directly from the applicant.
- iv. Banks/DFIs may use technology-based solutions like GPS, Geo-tagged on-boarding data, Video KYC recordings etc. for verification of SMEs' business owners and their business premises. They can also use anchor issued confirmations for the SMEs on-boarded via validated anchors (e.g., manufacturers, distributors, digital aggregators, digital platforms).
- v. Banks/DFIs shall permit the execution of e-agreements using secure digital signature platforms.
- vi. All SME credit-related documentation shall also be accepted in digital form, including renewals, declarations and agreements.

b. Digital Supply Chain Financing

Banks shall offer Digital Supply Chain Financing (DSCF) solutions to SMEs. For the purpose, they will either use their own solutions or develop partnerships with fintechs providing such solutions.

Regulation R-15: Credit Scoring Models

Banks/DFIs shall either develop their own digital credit scoring models or develop partnerships with reputed third parties, fintechs etc. to determine credit score of the applicant SMEs. The models, inter alia, shall have the capacity to leverage the data like: i) transactional and cash flow data, ii) bank account activity, iii) digital supply chain data, and iv) other verifiable alternate data sources.

Regulation R-16: Turnaround Time (TAT)

- i. Banks/DFIs shall process SME credit applications with complete KYC and relevant financial data within 15 working days.
- ii. To support this, Banks/DFIs shall implement automated underwriting systems, digital credit evaluation workflows, digital risk governance, automated credit scoring and straight-through processing wherever applicable.
- iii. Internal Audit and SME Governance Committees shall review TAT compliance on a periodic basis.
- iv. In case of repeated or material violations of the prescribed TAT, the Management Committee referred in R-4 above shall take appropriate remedial actions, including process improvements, accountability measures, and appropriate actions against responsible officials.

Regulation R-17: Classification and Provisioning for Loans/ Advances

- i. Banks/DFIs shall classify their SME finance portfolio and determine provision there-against as per the criteria given in Annexure I & II of these Regulations.
- ii. Banks/DFIs may avail the benefit of Forced Sale Value (FSV) of collateral held against loans/ advances, determined in accordance with the guidelines laid down in Annexure II, before making any provision. Banks/DFIs while taking the benefit of FSV in computing the provisioning requirement against a non-performing loan/advance to an SME, shall ensure that the FSV of collateral is determined accurately as per guidelines given in these PRs and is reflective of market conditions under forced sale situations.
- iii. Party-wise details of cases, where banks/DFIs have taken the benefit of FSV shall be maintained for verification by State Bank's teams during their regular/ special inspection.
- iv. In case of cash recovery, banks/DFIs may reverse specific provision held against classified assets only to the extent of the cash recovery.
- v. The external auditors shall, as part of their annual audits of banks/DFIs, verify that all requirements as stipulated above and in Annexure I & II for classification and provisioning have been complied with. SBP shall also check the adequacy of provisioning during on-site inspection.

Regulation R-18: Rescheduling/ Restructuring of Loans/ Advances

The banks/DFIs may reschedule/ restructure problem loans/advances as per their own policy duly approved by their Board of Directors. However, the rescheduling/ restructuring of non-performing loans shall not change the status of classification of a loan/advance etc. unless the following minimum conditions are met:

- i. At least 10% of the outstanding loan/advance amount is recovered in cash and the terms and conditions of rescheduling/ restructuring are fully met for a period of at least six months (excluding grace period, if any) from the date of such rescheduling/ restructuring. However, in case of recovery of 35% of the outstanding loan/advance amount (principal + mark-up), in cash either at the time of restructuring agreement or any time before the completion of six months period, the classification category can be changed at the time such recovery is affected.
- ii. Rescheduling shall not be done simply to avoid classification.
- iii. While reporting to the Credit Information Bureau (e-CIB) of SBP or any Credit Information Bureau licensed and regulated by SBP, such loans/ advances may be shown as 'rescheduled/ restructured instead of 'default'.
- iv. Rescheduling/ restructuring of a loan/advance account shall not lead to disqualification of the borrower for fresh credit facilities or enhancement in the existing limits. Such fresh loans/advances may be monitored separately, and shall be subject to classification on the strength of their own specific terms and conditions.
- v. Where a borrower subsequently defaults (either principal or mark-up) after the declassification of the rescheduled/restructured loan/advance, the loan/advance shall again be classified in the same category it was in at the time of rescheduling/ restructuring and the unrealized mark-up on such loans/advances taken to income account shall also be reversed.
- vi. At the time of rescheduling/ restructuring, banks/DFIs shall consider and examine the requests for working capital strictly on merit, keeping in view the viability of the project/ business and appropriately securing their interest etc.

Regulation R-19: General Measures

- i. Banks/DFIs shall put in place a Credit Proposal Tracking Mechanism (CPTM) to facilitate central registration and a system of e-tracking of all SME loan applications. This mechanism shall automatically generate an acknowledgement of the application, having a unique application serial number for both physical and online applications. Further, it shall also be ensured that the acknowledgement and status of the application is sent automatically to the applicants.

- ii. Banks/DFIs shall put in place an efficient Management Information System (MIS) for their SME financing portfolio enabling the management to have full and timely visibility of the portfolio size, growth trends, sectoral, geographic and gender dispersion, quality etc.
- iii. Banks shall establish a dedicated SME helpline along with a digital complaint submission system having real-time tracking and resolution mechanisms.
- iv. Banks/DFIs shall ensure compliance with SBP's complaint management framework, including the use of the "Sunwai" portal available at SBP website (<https://sunwai.sbp.org.pk>). They shall ensure timely resolution of SME-related complaints, status updates on the portal, and regular senior management oversight. Banks/DFIs shall actively promote awareness of Sunwai among SME customers through digital channels and banking touchpoints.

Annexures to Prudential Regulations for Small & Medium Enterprise Financing

ANNEXURE-I

Prudential Regulations for SME Financing (Regulation R-17)

Guidelines in the Matter of Classification
and Provisioning for Assets

All Financing Facilities (including Short, Medium and Long Term)

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE
(1)	(2)	(3)	(4)
1. Substandard.	Where mark-up/ interest or principal is overdue by 90 days or more from the due date.	Unrealized mark-up/ interest to be kept in Memorandum Account and not to be credited to Income Account except when realized in cash. Unrealized mark-up/ interest already taken to income account to be reversed and kept in Memorandum Account.	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and 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 II, or as per IFRS-9 ECL, whichever is higher.
2. Doubtful.	Where mark-up/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law and 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 II, or as per IFRS-9 ECL, whichever is higher.
3. Loss.	(a) Where mark-up/ interest or principal is overdue by one year or more from the due date. (b) Where Trade Bills (Import/ Export or Inland 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 less the amount 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 II, or as per IFRS-9 ECL, whichever is higher.

Note:

- i. Classified loans/advances that have been guaranteed by the Government would not require provisioning; however, mark-up/interest on such accounts would be taken to Memorandum Account instead of Income Account.
- ii. Banks/DFIs may read these instructions in line with the IFRS-9 Application Instructions as per BPRD Circular Letter No. 07 of 2023, as amended from time to time.

ANNEXURE-II

Prudential Regulations for SME Financing (Regulation R-17)
Uniform Criteria for Determining the Value of Pledged Stock, Plant & Machinery
under Charge and Mortgaged Properties

1. Only liquid assets, pledged stock, plant & machinery under charge and residential, commercial and industrial property having registered or equitable mortgage shall be considered for taking benefit for provisioning, provided no NOC for creating further charge to another bank/ DFI/ NBFC has been issued by the bank/DFI. The aforesaid assets having pari passu charge shall be considered on proportionate basis of outstanding amount.
2. Hypothecated assets and assets with second charge & floating charge shall not be considered for taking the benefit for provisioning.
3. Banks/DFIs may 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/Advances (NPLs/NPAs) for calculating provisioning requirement as tabulated below:

Category of Asset	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/NPAs shall not be available after the period prescribed above.

4. Valuations shall be carried out by an independent professional evaluator who should be listed on the panel of evaluators maintained by the Pakistan Banks' Association (PBA). For selection and listing of the evaluators, PBA lays down the minimum eligibility criteria with the prior approval of the SBP. The evaluator, while assigning any values to the pledged stock, plant & machinery under charge and residential, commercial and industrial

mortgaged property, shall take into account all relevant factors affecting the salability of such assets including any difficulty in obtaining their possession, their location, condition and the prevailing economic conditions in the relevant sector, business or industry. The values of pledged stock, plant & machinery under charge and residential, commercial and industrial mortgaged property so determined by the evaluators must have to be a reasonably good estimate of the amount that could currently be obtained by selling such assets in a forced/ distressed sale condition. The evaluators should also mention in their report the assumptions made, the calculations/ formulae/basis used and the method adopted in determination of the values i.e. the forced sale value (FSV).

5. The valuation process shall include conducting a 'Full-Scope Valuation' of the assets in the first year and then followed by 'Desktop Evaluations' in the second and third year. Full-scope valuation shall be valid for three years from the date of last Full-scope valuation.

6. The following may be noted in respect of the Desktop and Full-Scope Valuations:

- Desktop Evaluation is defined as “an Interim Brief Review of Full-Scope Evaluation, so that any significant change in the factors, on which the full-scope valuation was based, is accounted for and brought to the notice of the lending bank/DFI.”
- In case the loans/advances exceed Rs 100 million, the Desktop Evaluation shall be done by the same evaluator, who had conducted the Full-Scope Valuation (the evaluator should be on the approved panel of the PBA) whereas for loans/advances below this threshold, the Desktop Evaluation may be done by banks/DFIs themselves or by the approved evaluators. For conducting Desktop Evaluation, the evaluators shall pay a short visit to the borrower's site. Banks'/DFIs' responsibility in this respect will be to ensure that the evaluator is contacted for conducting Desktop Evaluation, and is provided all necessary information which is materially important for the interim review.
- Desktop Evaluation shall be used for determining any additional provisioning requirement only and will not be applied for reducing the provisioning requirement, assessed on the basis of Full-Scope Valuation.
- In cases where the evaluators are not allowed by the borrowers to enter in their premises, the Full-Scope Valuation, conducted as such, will not be accepted for provisioning benefit.

7. SBP may check the valuations of the assets under mortgage/ charge, through an independent evaluator, on random basis, to verify the reasonableness of the valuations. The unjustified differences in the valuations of banks/DFIs and SBP shall render the

concerned bank/DFI and evaluator to penal actions including, inter alia, withdrawal of FSV benefit.

8. Various categories of assets to be considered for valuation would be as under (no other assets shall be taken into consideration):

a) Liquid Assets:

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

b) Mortgaged Property and Plant & Machinery under Charge:

Valuation of residential, commercial and industrial mortgaged 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, forced sale value 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, the operation of the godown(s) or warehouse(s) should be in the control of banks/DFIs and regular valid insurance and other documents should be available. In case of perishable goods, the evaluator should also give the approximate date of complete erosion of value.