



# **Islamic Financing Facility for Renewable Energy**



## List of Abbreviations

<b>IB</b>	Islamic Bank
<b>IBB</b>	Islamic Banking Branch
<b>IBI</b>	Islamic Banking Institution
<b>DFI</b>	Development Finance Institution
<b>PIFI</b>	Participating Islamic Financial Institution
<b>IFRE</b>	Islamic Financing Facility for Renewable Energy
<b>RF-IFRE</b>	Islamic Financing Facility for Renewable Energy Reserve Fund
<b>LTF</b>	Long Term Financing Facility
<b>ILTF</b>	Islamic Long Term Financing Facility
<b>SBP</b>	State Bank of Pakistan
<b>SBP BSC</b>	State Bank of Pakistan Banking, Services Corporation
<b>KW</b>	Kilo Watt
<b>MW</b>	Mega Watt
<b>NEPRA</b>	National Electric Power Regulatory Authority



## Key Terms and Definitions

**Customer:** The entity or person seeking or availing financing facility from the PIFI under the Islamic Financing Facility for Renewable Energy.

**Facility:** Finance / mudarabah investment(s) provided by State Bank of Pakistan (SBP) under the facility.

**General Pool:** General Pool means the Mudarabah-based pool of funds managed by the PIFI where funds of the majority of the depositors are invested /deployed.

**Grace Period:** A period at the beginning of the Mudarabah investment/financing during which only profit/rentals will be paid by customer. During this period SBP will not take back its investment from IBIs.

**Islamic Bank (IB):** Full fledged Islamic commercial banks including Islamic banking subsidiaries of conventional banks.

**Islamic Banking Branches (IBB):** Designated Islamic banking branches of conventional banks established under IBD Circular No.02 of 2004.

**Islamic Banking Institutions (IBIs):** Full fledged Islamic commercial banks, Islamic banking subsidiaries of conventional banks and Islamic banking branches of conventional banks.

**Mudarabah Investment:** An investment made on the basis of mudarabah by SBP in the general pool of PIFI for the purpose of this scheme.

**Scheme:** Scheme will be a combined reference to the facility along with the regulatory instructions issued hereunder.



## Islamic Financing Facility for Renewable Energy

In order to make available SBP's "Financing Facility for Renewable Energy" to Islamic Banking Institutions (IBIs) and Islamic DFIs (collectively referred as Participating Islamic Financial Institutions – PIFIs), a Mudarabah based "Islamic Financing Facility for Renewable Energy" is being launched. Under this facility, SBP acting as Rab-ul-Maal shall make Mudarabah investments in general pool of PIFIs. Mudarabah investment would be provided up-to 100% of financing, provided by PIFI to the eligible projects subject to maximum financing limit of Rs. 6 billion. The exposure of SBP shall be on all assets of the PIFI's general pool to the extent of SBP's investment, and therefore shall not be limited to the assets financed under the Facility.

This document comprises of the following two main sections:

1. **The Facility**, containing details of the scheme pertaining to scope and categories and their respective eligibility criteria, period of financing, assignment of financing limits for PIFIs and disclosure requirements etc. redemption / repayment of financing, period of Mudarabah investment,  
This section also covers the Shariah structure of the facility which discusses the disbursement of funds from SBP to PIFI under Mudarabah, investments being part of the general pool of assets of PIFI, profit/loss allocation & distribution, and expected return on financing and investment.
2. **Regulatory instructions** which contain instructions of the State Bank of Pakistan for PIFIs to follow under this scheme such as risk assessment, penalties and general terms and conditions.

### 1. The Facility:

#### 1.1. Scope of the Facility:

The financing under this facility shall be available for power projects / installations using alternative / renewable energy sources (solar, wind, hydro, biogas, bio-fuels, bagasse cogeneration, and geothermal as fuel). The facility is available under following two categories:

**Category I** - Financing to the prospective sponsors desirous of setting up of renewable energy power projects with a capacity ranging from more than 1 MW to 50 MW shall fall under Category – I of this facility.

**Category II** - Financing to the consumers (domestic, commercial or industrial) for installation of facility using renewable energy source for generation of electricity ranging from 4 KW to 1000 KW (0.004 MW to 1 MW) for own use or for supply to the distribution company shall fall under Category II of this facility.



### 1.2. Participating Islamic Financial Institutions (PIFIs):

- i. All Islamic Banking Institutions (IBIs) including full-fledged Islamic banks, Islamic banking subsidiaries and Islamic banking branches of conventional banks and all DFIs having authorized Islamic financing operations (IDFIs) under permission of SBP (collectively referred to as PIFIs) may participate in the scheme by submitting an application to the concerned department of SBP.
- ii. Islamic banking branches of conventional banks / DFIs may participate in the scheme by applying to SBP for allocation of sub-limit, subject to a maximum of 20% of the parent bank's limit under the Financing Facility for Renewable Energy, for utilization by Islamic banking branches under this scheme. SBP may consider request for enhancement of the ceiling of 20% on case-to-case basis depending upon the merit of each request and keeping in view size and operations of the Islamic banking business of the PIFI.
- iii. The applications will be processed in accordance with SBP's criteria as follows:
  - a. PIFI should meet the minimum capital adequacy requirements set by SBP from time to time.
  - b. PIFI should have minimum 3 years experience of project financing/long term financing (*Applicable only for financing under Category I of the scheme*).
  - c. PIFI should have profitable operations during last consecutive three years.
  - d. SBP would consider the requests of PIFIs keeping in view the CAELS ratings assigned by SBP as well as ratings assigned by Credit Rating Agencies in Pakistan.

### 1.3. Assigning Financing Limits for PIFIs:

- i. Each year SBP shall allocate / assign financing limits to individual PIFI under the facility on the basis of SBP's internal criteria. The total sum disbursed during a financial year by the PIFI under the scheme shall not exceed such assigned limit.
- ii. Applications for sanction of limits for each fiscal year (July-June basis) shall be sent by the interested PIFI to the Director, Infrastructure, Housing & SME Finance Department, each year on such date and in such manner as may be advised by SBP from time to time.
- iii. After sanction of limits for each fiscal year, the PIFI shall submit a duly executed agreement for availing the facility as per prescribed format (IFRE: 1 - Master Mudarabah Agreement) along with the names of offices of SBP BSC from where it intends to avail the facility.
- iv. The funds made available under the facility to PIFIs shall be provided by the designated offices of SBP BSC under the limits conveyed by the concerned department of SBP, Karachi in favor of each PIFI, on yearly basis.



- v. SBP shall review the utilization of limits by the PIFIs periodically and may cancel the unutilized limit for reallocation to other PIFIs. No PIFI shall be authorized to sanction financing with a view to merely utilize the limit under the scheme.

#### **1.4. Category I of the Facility:**

##### **1.4.1. Eligibility Criteria under Category I:**

- i. Financing shall be available to the prospective sponsors desirous of setting up of renewable energy power projects with a capacity ranging from more than 1 MW to 50 MW, who have completed prescribed requirements of Alternative Energy Development Board (AEDB) and other relevant Government Departments / Authority (Federal or Provincial), in compliance with the prevalent Renewable Energy Policy of the Government of Pakistan.
- ii. SBP's Mudarabah investment will be made up-to 100% of financing, provided by PIFIs to the eligible projects subject to adherence of other rules & regulation. However, maximum Mudarabah investment allowed under the Facility cannot be more than Rs. 6 billion for a single Renewable Energy Project.

##### **1.4.2. Period of Financing and Redemption / Repayment of Financing:**

- i. Financing of PIFI under Category I of this facility shall be available for a maximum period of twelve years including a maximum grace period of two years from the date of first disbursement. The grace period may vary depending upon the type of renewable energy source. Therefore, PIFIs shall clearly mention the "grace period" in the redemption / repayment schedule to be submitted to the concerned office of SBP BSC at the time of requesting Mudarabah investment.
- ii. The retirement of financial obligations/redemption under this Category shall be made by the customer on quarterly or half yearly basis after prescribed grace period, if any.
- iii. The profit/return/ rental shall however be payable on quarterly basis .

#### **1.5. Category II of the Facility:**

##### **1.5.1. Eligibility Criteria:**

- i. Financing shall be available to the consumers (domestic, commercial or industrial) willing to install facility using renewable energy source for generation of electricity ranging from 4 KW to 1000 KW (0.004 MW to 1 MW) for own use or for supply to the distribution company as per the rules set under "NEPRA (Alternate & Renewable Energy) Distributed Generation and Net Metering Regulations", as amended from time to time.



- ii. SBP's Mudarabah investment will be made up-to 100% of financing, provided by PIFIs to the eligible customers subject to adherence of other rules & regulation.

**1.5.2. Period of Financing and Redemption / Repayment of Financing:**

- i. The financing under this facility shall be available for a maximum period of 10 years with no grace period.
- ii. The retirement of financial obligations/redemption under this Category shall be made by the customer on monthly / quarterly basis.
- iii. The profit/return/ rental shall however be payable on quarterly basis.

**1.6. Period of Mudarabah Investment:**

- i. The Mudarabah investment made with the PIFIs shall mature on the due date agreed with SBP. Mudarabah investment redemption schedule shall be prepared based on the retirement of financial obligation/redemption by each customer under the facility.
- ii. SBP is authorized to deduct such amount from outstanding Mudarabah investment balance in the general pool, determinable as per "Instructions for Profit & Loss Distribution and Pool Management for Islamic Banking Institutions" issued vide IBD Circular No. 3 dated November 19, 2012, as amended from time to time. SBP shall recover such amount from the accounts of PIFI maintained with the respective offices of the SBP BSC.
- iv. In case a customer pays the financing amount or its installment, in part or in full, before the due date(s), SBP's share in the general pool will be redeemed equal to the payments so received from customer. PIFIs shall adjust the financing amount received from the customer by purchasing the SBP's proportionate share in the general pool immediately, but not later than three (03) working days, from the concerned office of SBP BSC, failing which the SBP shall also be given the profit, as per the actual profit of the general pool, for the number of days this proportionate share is not purchased by the PIFI. However, no penalty shall be charged either from PIFI or its customer in case of payment of financing amount or installment, in part or in full, before due date.

**1.7. Disbursement of Funds from PIFI to Customers / Projects:**

- i. The financing shall be allowed, subject to eligibility criteria given above, against a single or multiple underlying transaction(s), designed on the basis of permissible Islamic modes of finance (specified under Section E of Annexure I. of IBD Circular No.02 of 2008, as amended from time to time), and under the product / transaction structure approved by the Shariah Board of concerned PIFI. In case of consortium/syndication, the whole process, starting from the structuring of the transaction till its completion, should be duly approved and



monitored by Shariah Board of lead arranger / Shariah Committee formed for consortium/syndication, as the case may be.

- ii. The PIFIs shall reasonably ensure fulfillment of the pre-disbursement formalities by the customer through due diligence in accordance with their own internal arrangements to avoid mis-utilization of the facility through over invoicing, etc. while extending financing facilities to the customers. PIFIs shall comply with all relevant regulations issued by SBP from time to time regarding the mode under which the financing has been extended.
- iii. The PIFIs shall undertake due diligence process in accordance with their respective financing policies before sanctioning the facility subject to the respective prudential regulations prescribed by the SBP for each type of customer.
- iv. PIFIs shall at all times remain within the limits assigned to them for disbursements/financing under the scheme in a given financial year. Facilities should not be sanctioned in favor of customers in anticipation of sanction of limits by the SBP.
- v. Disbursements by PIFIs should not be made to the customer directly; instead, payments shall be made to the manufacturers/suppliers/vendor/contractor.
- vi. The PIFIs shall adhere to their internal credit risk rating policies developed in compliance with SBP's Guidelines on Internal Credit Risk Rating Systems issued vide BSD Circular No. 8 of 2007. In case the customer of PIFI is a corporate / commercial or industrial entity, the same should have minimum rating of 4 as per the above circular.
- vii. The PIFI undertakes to advise SBP promptly of any change in the position of any customer provided with finances by the PIFI under the scheme.

#### **1.8. Disclosure in Annual Audited Accounts:**

- i. The external auditors of the PIFI shall, during the course of annual audit, verify compliance of the PIFI with the terms and conditions of the scheme, specially relating to SBP's share in Mudarabah investment, profit calculations and payments made on SBP's Mudarabah investment. A 'Certificate of Compliance' shall be issued to the PIFI and a copy thereof should be sent by PIFI to the SBP (concerned department).
- ii. These facts shall be disclosed separately under appropriate heads, in the annual audited financial statements of the PIFI, the aggregate amount of Mudarabah investment made by SBP in such PIFI, as may be outstanding and payable by it, on the date of the preparation of its financial statements.

#### **1.9. Grant of Mudarabah Investment:**





SBP shall make Mudarabah investments in PIFIs on the basis of Section 17 (6B) of the SBP Act 1956.

#### **1.10. Shariah Structure of the Facility:**

##### **1.10.1. Disbursement of Funds from SBP to the PIFI under Mudarabah**

- i. After making disbursement(s) on account of any of the categories of the facility, PIFI shall approach concerned office of SBP BSC for obtaining Mudarabah investment to the extent of 100% of the amount disbursed/financed on case to case basis for each project.
- ii. The Mudarabah investment by SBP shall be made on the basis of certification by the Internal Audit of PIFI with regard to confirmation that the financing is within the terms and conditions laid down in respective category of the facility. A copy of the said Internal Audit Certificate shall also be submitted to the concerned office of SBP BSC along-with Mudarabah Investment Request Form.
- iii. The SBP BSC office shall provide Mudarabah investment on receipt of request from PIFIs submitted through duly filled-in prescribed documents i.e.
  - a. IFRE: 2 – Mudarabah Investment Request Form
  - b. IFRE: 3 – Debit Authority
  - c. IFRE: 4 – Copy of Demand Promissory Note (by the customer)
  - d. IFRE: 5 – Undertaking to be Submitted by the customer
  - e. Copy of Internal Audit's certificate obtained in terms of Para 1.10.1 (ii) above.
  - f. Copy of Financing Agreement between PIFI and customer (inclusive of redemption schedule).
  - g. Any other document(s), advised by SBP, from time to time

##### **1.10.2. Investments being Part of the General Pool of Assets of PIFI:**

- i. The funds obtained from SBP shall be part of the PIFI's general pool and thus shall be subject to the risks and rewards of the pool's assets like other depositors of the pool.

##### **1.10.3. Expected Return on Financing and Mudarabah investment:**

- i. The expected rate of return / profit / rentals on financing provided by the PIFIs to their customers shall not exceed rates announced by SBP on similar refinance facilities from time to time.
- ii. Further, SBP expects profit rate/return on its Mudarabah investments with PIFIs to be close to its return on such type of refinance facilities.



- iii. The expected rate of return on financing once fixed shall remain locked-in for the entire duration of the financing, provided that the customers continue to pay all scheduled amounts at the respective due dates. In case the customer(s) fails to make payment of the amount of installment as per the original payment schedule, provisions of the late payments as stipulated in the underlying financing agreement with the customer shall apply for the overdue period besides taking other actions to recover the same as per its approved policies for recovery in similar cases.
- iv. In cases where the financing amount has not been disbursed in full during the validity of an applicable rate, the un-disbursed amount shall attract the new expected rate of return applicable from the date of disbursement by the PIFI.

#### **1.10.4. Allocation and Distribution of Profit / Loss:**

- i. SBP's investment in the general pool, under both the categories shall be assigned profit sharing ratio and weightages keeping in view SBP's expected rate of return as well as PIFI's policy and practice for such type of depositors in the general pool. This weightages shall be used to calculate profits on the SBP investments under the facility.
- ii. At the end of every month, but not later than the 7<sup>th</sup> working day of the following month, after calculating actual profit of the general pool by the PIFI, SBP's share of profit will be credited into a separate non-remunerative account held with the PIFI in the general pool. The profit accumulated in this account shall be transferred to SBP on quarterly basis, including during the grace period, if any, within 7 working days of completion of each quarter. No profit shall accrue or be applicable on the amount standing to the credit of the reserve account.
- iii. The determination of profit will be made in line with "Instructions for Profit & Loss Distribution and Pool Management for Islamic Banking Institutions (IBIs)" issued vide IBD Circular No.3 dated November 19, 2012, as amended from time to time.

#### **1.10.5. Islamic Financing Facility for Renewable Energy Reserve Fund – (RF-IFRE):**

- i. SBP shall create a Reserve Fund (RF) at SBP BSC from its share in profits of the scheme. If in any quarter, SBP's share in profit is more than the expected return; such excess profit shall be transferred to the RF-IFRE. The PIFIs shall advise the SBP BSC offices accordingly, within 7 working days of close of quarter, by issuing separate advice for transfer of excess amount into 'RF-IFRE'.

#### **1.10.6. Loss Sharing:**



- i. If at any time the general pool of a PIFI suffers a loss, it shall be borne by all the depositors / fund providers of the general pool, including SBP, to the extent of their respective ratios of investments in the general pool.
- ii. The PIFI will be responsible for any loss incurred to SBP under this facility, if the said loss is subsequently proven to have been caused on account of negligence/mis-statement and/or misrepresentation, on the part of PIFI, determined by internal auditor, external auditor and/or SBP inspection team.

## **2. Regulatory Instructions:**

### **2.1. Risk Assessment:**

- i. Each PIFI shall be required to have:
  - a) Well defined policies and established procedures for appraisal of projects to be financed under Category I of the facility, particularly with regard to their technical and financial viability.
  - b) Robust internal controls to protect depositors'/rab-ul-maals' and PIFI's interest and to fulfill all requirements/conditions of financings including collateral requirements to mitigate the risk of customers' failure to honor their commitments. The risk assessment policy should cover varying business requirements and provide well-defined methodologies for assessing the financial fitness of prospective customers and project.
- ii. PIFIs shall undertake necessary due diligence process as per their financing policies, approved by the Shariah Board and Board of Directors, before sanctioning the financing facility under the scheme and ensure compliance with all applicable prudential regulations and SBP instructions. Further, in case the financing is provided for import of any machinery / equipment etc, PIFIs shall obtain satisfactory credit reports on suppliers & manufacturers of equipment and machinery etc. as required under chapter XIII of Foreign Exchange Manual. Furthermore, the sanction/approval of the financing shall be linked to the risk profile of the potential customers as per PIFI's risk measurement / assessment policies.

### **2.2. Penalties:**

- i. SBP, in its capacity as the regulator, shall have the right to appoint an independent consultant to verify that the conditions of the scheme are properly fulfilled/complied with by PIFI.
- ii. In case the report of the consultant points out irregularities on the part of the PIFI or the customer, SBP reserves the right to redeem the amount of Mudarabah investment made with the PIFI along with penalty at the rate prescribed in sub clause 2.2 (vi) below including the cost of such verification.



- iii. It will be the responsibility of the PIFIs to secure their interest and the interest of depositors/investors in this regard, however, in no case fine imposed on PIFI due to its negligence shall be passed on to the customer. In case, any PIFI passes on the fine to the customer, the PIFI shall be under obligation to justify the same to ensure that the fine is not passed on to the customer merely on the strength of the action of SBP.
- iv. Notwithstanding anything contained in clauses 2.2 (i, ii & iii) above, in case the customer(s) fails to repay / pay the amount of installment as per the original repayment / payment schedule, the delay would trigger collection of charity amount from the customer as per the undertaking given by the customer. Any charity amount collected by the PIFI from customers relating to the delay in payment of financings under the facility will be given by the PIFI in charity as per SBP's instructions on the matter. However, in some modes of financing the PIFI has a right, under Shariah principles, to take additional amount in cases of delays and defaults, e.g. as rent on un-purchased share in underlying asset. The same shall be subject to prior approval of PIFI's Shariah Board.
- v. The customers shall continue to remain liable for payment of fines/penalties on account of their non-performance/non-compliance to the requirements of the scheme. Such fines/penalties as and when recovered, from the customers shall invariably be passed on to SBP by the concerned PIFI. The failure of the PIFIs on this account shall be construed as their non-compliance of the scheme, and would attract punitive measures as prescribed by SBP.
- vi. In case of violation of the terms & conditions laid down in the facility, SBP shall reserve the right to recover the outstanding Mudarabah investment with the PIFI, or part thereof along with fine at the rate of Paisa 60 per day per Rs 1000/- and the cost of verification as stated in sub clauses 2.2 (i & ii) above.

### **2.3. General Terms & Conditions (Both Categories):**

- i. The PIFIs shall submit their operations/process manual of the scheme to the IH&SMEFD of SBP for information and review before launching the scheme/seeking limits and shall reasonably address the observations if any raised by the department.
- ii. PIFIs shall ensure that financing proceeds are used exclusively for the purpose it is approved. They shall also ensure that customer has fulfilled pre-disbursement formalities, through due diligence as per their own internal arrangements to avoid malpractices and misutilization of funds under the facility.
- iii. Besides applying due diligence process as per their financing policies, standard / appropriate procedures in such types of financing, PIFI may also impose any specific condition(s) considered appropriate by them, subject to its Shariah Board's approval, in such type of transactions, while sanctioning finance under the facility to protect their interests.



- iv. PIFIs shall provide financing facilities to the prospective customers as per their financing policies duly approved by their Board of Directors and Shariah Board. Further, financing shall be subject to compliance with all rules, regulations and instructions, including Shariah compliance related instructions etc. as prescribed by the State Bank, from time to time. PIFIs shall also ensure compliance, in all their financings, to the Shariah principles, process flows and product structure etc. as approved by their respective Shariah Board, in line with SBP's instructions and guidelines, issued from time to time.
- v. Financings under the facility shall be checked/verified by SBP's Banking Inspection Department (BID) during inspection of the PIFI to ensure that the same has been allowed as per the terms and conditions of the Scheme.
- vi. In case of early repayment / payment of principal / installments or rescheduling of financing, the concerned PIFI shall be required to submit revised repayment schedule of that financing.
- vii. Fixed term financings which have been extended prior to the announcement of this facility shall not be eligible for this facility.
- viii. PIFIs should ensure adequate training arrangements for the staff/officials handling cases under the scheme with a view to ensure compliance with internal rules/regulations/procedures and those prescribed by SBP.
- ix. Second-hand machinery / equipment shall not be eligible under the facility.
- x. The PIFI will be responsible for any loss incurred to SBP under this facility, if the said loss is subsequently proven to have been caused on account of negligence/mis-statement and/or misrepresentation, on the part of PIFI, determined by internal auditor, external auditor and/or SBP inspection team.
- xi. Financing under the scheme shall be subject to compliance with all rules and regulations including Prudential Regulations. Further, compliance with the instructions related to foreign exchange regulations/ policy must be ensured, for which Exchange Policy Department of SBP may be contacted separately.
- xii. Financing shall be available for new systems installed / new projects initiated from the date of issuance of this circular and shall remain valid till further instructions.

#### **2.4. Terms and Conditions specific to Category I**

- i. Disbursements of the financing amount by the PIFI shall be linked to valid project completion / development milestones.
- ii. PIFIs shall not take more than three months in evaluating an application for financing under this facility from the date of receipt of complete information from the customer. Where the request is declined, the PIFI will explicitly apprise the reasons for rejecting the application to the prospective customer.
- iii. Moreover, PIFIs may also ensure that firm commitments for the portion of funding not to be financed by SBP (in the form equity, other bank financings etc.) are available for the project being financed by them under the facility, so that the



project does not eventually suffer due to any funding gap. Firm equity commitment from the sponsors may be made in the form which is satisfactory for the financing PIFI. State Bank of Pakistan would, however, not insist on fulfillment of this condition by a specified mode but would let the PIFI to satisfy itself in this regard.

- iv. Captive power projects which have already availed financing facilities under LTFF, ILTFF or SBP Financing Scheme for Renewable Energy scheme shall not be eligible for financing under this scheme.
- v. PIFIs shall ensure that contracts/agreements between sponsors and suppliers/contractors etc are made on arms-length basis in order to avoid any conflict of interest.
- vi. Subject to maximum Mudarabah investment from SBP of Rs. 6 billion per project, PIFIs may structure loan as per their own terms & conditions for any amount exceeding this limit.

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