

**Islamic Refinance Scheme for Working  
Capital Financing of Small Enterprises  
and Low-End Medium Enterprises  
(IWCF)**

## **List of Abbreviations**

<b>C&amp;F</b>	Cost and Freight
<b>IB</b>	Islamic Bank
<b>IBB</b>	Islamic Banking Branch of Conventional Bank
<b>IBI</b>	Islamic Banking Institution
<b>LC</b>	Letter of Credit
<b>PIFI</b>	Participating Islamic Financial Institutions including IBIs and Islamic DFIs
<b>SBP</b>	State Bank of Pakistan
<b>SBP BSC</b>	State Bank of Pakistan Banking Services Corporation
<b>SME</b>	Small and Medium Enterprise

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## Key Terms and Definitions

**Customer:** The entity or person seeking or availing financing facility from the Participating Islamic Financial Institution (PIFI) under the Islamic Refinance Scheme for Working Capital financing of Small Enterprises and Low-End Medium Enterprises (IWCF).

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

**General Pool:** General Pool means the mudarabah-based pool of funds managed by the Participating Islamic Financial Institution (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 customers of PIFIs. During this period, SBP will not take back its investment from PIFIs.

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

**Islamic Banking Branches (IBBs):** 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.

**Participating Islamic Financial Institution (PIFI):** IBIs (IBs and IBBs) and Islamic DFIs approved by SBP to participate in the scheme.

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

**SME Customers:** Refer to SMEs as defined in SBP Prudential Regulations for SME financing.

## **Islamic Refinance Scheme for Working Capital Financing of Small Enterprises and Low-End Medium Enterprises**

The Islamic Refinance Scheme for Working Capital financing of Small Enterprises and Low-End Medium Enterprises (IWCF) has been offered to Islamic Banking Institutions (IBIs) and Islamic Development Financial Institutions (Islamic DFI); collectively referred to as Participating Islamic Financial Institutions (PIFIs). State Bank of Pakistan (SBP) shall make mudarabah investment in PIFIs under section 17 (6B) of the SBP Act, 1956 (the "SBP Act"). SBP will act as Rab-ul-Maal by providing mudarabah investment facility to the PIFIs, in the form of investment in a PIFI's general pool, and the PIFI shall act as the Mudarib of general pool. The exposure of SBP under the scheme shall be on all assets of a PIFI's general pool to the extent of SBP's investment in general pool, and therefore shall not be limited to the assets financed under the scheme.

This document comprises of the following two main sections:

1. **The Facility** contains details of the scheme viz. scope and eligibility criteria, period of investment and payments, sectors eligible for financing, assigning financing limits for PIFIs, disbursement of funds from PIFIs to customers and disclosure in annual audited accounts. This section also covers the Shariah structure of the facility which discusses the disbursement of funds from SBP to PIFIs under mudarabah, investments being part of the general pool of assets of PIFIs, expected rate of return on financing under the scheme and profit/ loss allocation & distribution.
2. **Regulatory instructions**, which contain instructions of the SBP for PIFIs to follow under this scheme such as risk assessment, penalties and general terms and conditions.

### **1. The Facility**

#### **1.1. Scope and Eligibility:**

- i. The PIBIs shall provide local currency finance for working capital requirements of below mentioned SME sectors:

Information Technology (IT)	Gems and jewelry
Furniture	Leather industry
Surgical goods	Fruits, vegetables and food processing & packaging
Dates processing	Printing & packaging

- ii. All small enterprises (SEs) as defined in SBP's Prudential Regulations (PRs) for SME financing will be eligible under the scheme. SEs can avail financing upto the per party maximum financing limit allowed under PRs for SME financing.
- iii. Medium enterprises (MEs) with annual sales of upto Rs 300 million will be eligible under the scheme.
- iv. Maximum financing limit for MEs is Rs 50 million.
- v. The PIFIs will approve the borrowing limits of eligible customers (SMEs) keeping in view their credit requirements, cash flows, repayment capacity and risk profile.

- vi. Maximum financing tenor will be one year.

### **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 for granting the status of approved PIFI..

### **1.3. Assigning Financing Limits for PIFIs:**

- i. Limits shall be allocated to individual PIFIs under the scheme. These limits shall remain valid till finalization of the new limits by State Bank of Pakistan. 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 shall be sent by the interested PIFIs to the Director, Infrastructure, Housing & SME Finance Department of SBP on such date and in such manner as may be advised by SBP from time to time.
- iii. After the sanction of limit by SBP, PIFI shall submit application along with duly executed agreement for availing the facility (as per prescribed format IWCF-1) and IWCF 1 - Annex), stating the names of the offices of SBP BSC from where they intend to avail the facility.
- iv. The funds made available under the scheme 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.
- v. SBP shall review the utilization of limits by the PIFIs periodically (quarterly) and may cancel/ reduce the unutilized limit. No PIFI shall be authorized to sanction financing with a view to merely utilize the limit under the scheme.

### **1.4. Period of Investment and Payments:**

- i. The maximum period for which the investment under the scheme may be made shall not be more than one (1) year.
- ii. The retirement of financial obligations/ redemption under the scheme shall be made by the customers within one year from the date depending upon the tenure for which the facility is availed and underlying mode of Islamic finance used by PIFIs.
- iii. The mudarabah investment made with the PIFIs shall mature on the due date agreed with SBP, and SBP is authorized to deduct outstanding balance of its investment in the general pool 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.

- iv. In case a customer pays the financing amount or its installment, in part or in full, on or before the due date(s), SBP's share in the general pool will be redeemed equal to the payments received from customer. PIFIs shall adjust the financing amount so received from the customer by purchasing the SBP's proportionate share in the general pool immediately, but not later than two (02) 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 a PIFI. However, no penalty shall be charged either from a PIFI or its customer in case of payment of financing amount or installment, in part or in full, before due date.

#### **1.5. Disbursement of Funds from PIFIs to Customers:**

- i. The financing shall be allowed against a single or multiple underlying transaction(s), designed on the basis of Islamic modes of financing, approved by the Shariah Board of the concerned PIFI. The modes of finance will include all those modes listed in Section E of Annexure-I of IBD Circular No. 02 of 2008, as amended from time to time; including combination of those Islamic modes of financing (hybrid arrangements).
- ii. The PIFIs shall undertake due diligence process in accordance with their respective financing policies before sanctioning the facility subject to Prudential Regulations for SME financing. 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 SBP.
- iii. The PIFIs shall reasonably ensure fulfillment of the pre-disbursement formalities by the customers 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,
- iv. The PIFIs shall not take more than 15 days in case of small enterprises (SEs) and 25 days in case of medium enterprises (MEs) in evaluating an application for financing under the scheme from the date of receipt of complete information from the customer. Where the request is declined, the PIFI shall explicitly explain the reason for rejecting the application to the prospective customer.
- v. Disbursements by PIFIs should not be made to the customers directly. Payments shall be made to the suppliers of the customers.
- vi. The PIFIs shall undertake to advise SBP promptly of any change in the position of any customer provided with finances by the PIFI under the scheme.

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

- i. The external auditors of the PIFIs shall, during the course of annual audit, verify compliance of the PIFIs with the terms and conditions of the scheme, especially 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 concerned PIFI and a copy thereof should be sent by PIFIs to the SBP (concerned department).
- ii. The above facts shall be disclosed separately under appropriate heads, in the annual audited financial statements of the PIFIs.

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

#### **1.7.1. Disbursement of Funds from SBP to PIFIs under Mudarabah**

- i. After making disbursement(s) on account of the facility to the customer, the PIFI shall approach the concerned office of SBP BSC for obtaining mudarabah investment to the extent of the amount disbursed/ financed to the customer.
- 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 at the time of obtaining Mudarabah investment.
- iii. The SBP BSC office shall provide mudarabah investment within two (02) working days from the date of receipt of request on submission of duly filled in prescribed documents
  - a. IWCF:2-Mudarabah Investment Request Form (IWCF-2)
  - b. IWCF:3-Debit Authority (IWCF-3)
  - c. IWCF:4-Copy of Demand Promissory Note by PIFI's customer (IWCF-4)
  - d. IWCF:5-Undertaking of the customer on the format
  - e. Financing Agreement between PIFI and customer (inclusive of redemption schedule)
  - f. A copy of Internal Audit Certificate as per Para 1.7.1 (ii) above.
  - g. Any other document(s), advised by SBP, from time to time.

#### **1.7.2. Investments being Part of the General Pool of Assets of PIFIs:**

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

#### **1.7.3. Expected Return on Financing under the scheme:**

- i. The expected rate of return on financing provided by the PIFI to its customer under the scheme may not exceed rates announced by SBP on similar refinance facilities. Further, SBP expects profit rates/ return on its investment close to its return on such type of refinance facilities.
- ii. 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.

- iii. 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.

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

- i. The SBP's investment in the general pool will be assigned profit sharing ratio and weightage 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. Such weightages shall be used to calculate profits on SBP investments.
- ii. At the end of every month, but not later than the 7<sup>th</sup> working day of the following month, after calculation of the actual profit of the general pool by the PIFI, SBP's share of profit will be appropriated for credit into a separate non-remunerative account held with the PIFI. The profit accumulated in this account shall be transferred to SBP within 7 working days from the close of a quarter. No profit shall accrue or be applicable on the amount standing to the credit of reserve account-
- iii. The determination of profit will be made in line with section 2 of "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.

#### **1.7.5. Islamic Refinance Scheme for Working Capital Financing of Small Enterprises and Low-end Medium Enterprises Reserve Fund (RF-IWCF)**

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

#### **1.7.6. Loss Sharing:**

- i. If at any time the general pool of a PIFI suffers a loss, it shall be borne by all the depositors 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, as 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 the scheme, particularly with regard to their technical and financial viability.
  - b) robust internal controls to protect depositors'/ rab-ul-maal' and PIFI's interest and to fulfill all requirements/ conditions of project financing 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.
- ii. SBP shall allocate/ assign financing limits under IWCF to each PIFI based on SBP's internal criteria.
- iii. PIFIs shall undertake necessary due diligence process as per their financing policies before sanctioning the financing facility under the scheme and ensure compliance with all applicable prudential regulations and SBP instructions.
- iv. Financing under the scheme shall be checked/ verified by onsite inspection teams of SBP during inspection of the PIFIs to ensure that the same have been allowed as per the terms and conditions of the scheme.

### **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 (such as over invoicing, ineligible sectors etc) on the part of the financing 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 of delay in payment by the customer, the delay would trigger the collection of charity amount

from the customer as per the undertaking given by the customer. Any charity amount collected by the PIFIs from customers relating to the delay in payment of financing will be given by the PIFIs to charity. Similarly, in case of delay, the PIFIs shall also have the right to recourse to the security of the customer, where such risk management provisions have been adopted to recover the amounts due. In some modes of financing, the PIFIs have a right to take additional amount in cases of delays and defaults as rent on un-purchased share in underlying asset. The same shall be approved by Shariah Boards of PIFIs.

- 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 scheme, the SBP shall reserve the right to impose & recover the fine/ penalty at the rate of paisa 60 per day per Rs. 1000/- or part thereof including the cost of verification as stated in sub-clauses 2.2(i & ii) above.

### **2.3. General Terms and Conditions:**

- i. PIFIs shall submit their operations/ process manual of the scheme to the concerned department 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. The cost of takaful/ insurance, transit insurance/ transit takaful, and other incidentals shall not be financed under the scheme.
- iii. Financing under the scheme shall be subject to compliance with all rules and regulations including Prudential Regulations for SME financing.
- iv. PIFIs shall ensure fulfillment of requisite pre-disbursement formalities by the customers through due diligence as per their own internal arrangements to avoid malpractice and mis-utilization of funds under the scheme.
- v. 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.