SECURITIES & EXCHANGE COMMISSION OF PAKISTAN
SPECIALIZED COMPANIES DIVISION
NBFC DEPARTMENT

No. SC/NBFC-PR/ /2004
January 21, 2004.

CIRCULAR NO. 2 OF 2004

Subject: **PRUDENTIAL REGULATIONS FOR NON-BANKING FINANCE COMPANIES (NBFCs)**

The Securities and Exchange Commission of Pakistan (SEC), in exercise of powers conferred by section 282D of the Companies Ordinance, 1984 (the "Ordinance") hereby directs all Non-Banking Finance Companies (NBFCs) undertaking the business of Investment Finance Services, Leasing, Housing Finance Services, Venture Capital Investment, Discounting Services, Investment Advisory Services and Asset Management Services to conduct their businesses in conformity with the directions/regulations enclosed herewith as Prudential Regulations for NBFCs (the "Regulations"). These Regulations shall be effective from January 21, 2004.

The Regulations were necessitated pursuant to the amendments in the Ordinance, whereby all the existing NBFIs with the exception of Modarabas and Development Financial Institutions (DFIs) have been re-classified as NBFCs and are being regulated by SEC w.e.f. November 15, 2002. The objective behind the issuance of these Regulations is to introduce a uniform set of Regulations for all NBFCs in order to improve their effective risk management capabilities and to promote corporate governance in the non-bank financial sector.

These Regulations are being issued in supercession of SEC's Circular No. 15 of 2002 dated 2-12-2002, Circular No. 18 of 2003 dated 31-7-2003 and Circular No. 21 of 2003 dated 25-8-2003, regarding Prudential Regulations. However, it is darified that the NBFCs, House Building Finance Corporation (HBFC) and Investment Corporation of Pakistan (ICP) shall continue to submit all the information, returns and statements etc. to SEC and Credit Information Bureau (CIB) of State Bank of Pakistan in the same manner and format as previously prescribed.

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NBFCs are advised to ensure circulation of Regulations among all their officers / branches for meticulous compliance in letter and spirit. Any violations or circumvention of these Regulations shall be dealt with under the provisions of the Ordinance.

The new set of Regulations has also been placed on SEC Website www.secp.gov.pk for information of the concerned quarters and general public.

Please acknowledge receipt.

(Asif Jalal Bhatti)
Joint Director

Distribution:

1. Chief Executives of all NBFCs
2. Managing Directors of all Stock Exchanges
3. The Chairman, Investment Banks Association of Pakistan
4. The Chairman, Leasing Association of Pakistan
5. The Chairman, Mutual Funds Association of Pakistan
6. The Chairman, ICP
7. The Managing Director, HBFC
8. Director, Banking Supervision Department, State Bank of Pakistan
9. The President, Institute of Chartered Accountants of Pakistan
10. The President, Institute of Cost and Management Accountants of Pakistan
11. All Divisions of SEC
12. All CROs

PRUDENTIAL REGULATIONS FOR NON-BANKING FINANCE COMPANIES

Part - I

Definitions.— (1) In these guidelines, unless there is anything repugnant in the subject or context:-

(a) **Borrower** includes a person on whom a NBFC has taken any exposure during the course of business.

(b) **Contingent liability** means:

(i) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(ii) a present obligation that arises from past events but is not recognized because:

(a) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
(b) the amount of the obligation cannot be measured with sufficient reliability;

and includes letters of credit, letters of guarantee, bid bonds / performance bonds, advance payment guarantees and underwriting commitments.

(c) **Documents** include vouchers, cheques, bills, pay-orders, promissory notes, securities for leases / advances and claims by or against the NBFC or any other record / papers supporting entries in the books of a NBFC.

(d) **Equity of the Borrower** includes paid-up capital, general reserves, balance in share premium account, reserve for issue of bonus shares and retained earnings / accumulated losses, revaluation reserves on account of fixed assets and subordinated loans.

Explanation: Revaluation reserves will remain part of the equity for first three years only, from the date of asset revaluation, during which time the borrower will strengthen its equity base to enable it to avail facilities without the benefit of revaluation reserves.

(e) **Exposure** includes facilities and subscription to or investment in shares.

Explanation: Secured exposure means exposure backed by tangible security and any other form of security with appropriate margins (in cases where margin has been prescribed by SEC, appropriate margin shall at least be equal to the prescribed margin). Clean exposure means exposure without any security or collateral.

(f) **Financial Institutions** includes, –

(a) a company or an institution whether established under any special enactment and operating within or outside Pakistan which transacts the business of banking or any associated or ancillary business through its branches;

(b) a modaraba, leasing company, investment bank, venture capital company, financing company, housing finance company, a non-banking finance company and a bank or any institution duly licensed by State Bank of Pakistan;

(c) such other institution or companies authorised by law to undertake any similar business, as the Federal Government may, by notification in the official Gazette, specify for the purpose;".

(g) **Forced Sale Value (FSV)** means the value which fully reflects the possibility of price fluctuations and can currently be obtained by selling the mortgaged / pledged/ leased/collaterally held assets in a forced / distressed sale conditions.

(h) **Government Securities** include monetary obligations of the Federal Government or a Provincial Government or of a Corporation wholly owned or controlled, directly or indirectly, by the Federal Government or a Provincial Government and guaranteed by the Federal Government and any other security as the Federal Government may, by notification in the Official Gazette, declare, to the extent determined from time to time, to be Government Securities.

(i) **Group** means persons, whether natural or juridical, if one of them or his family members including spouse, lineal ascendants and descendants and brothers and sisters or its subsidiary, have control or hold substantial ownership interest or have power to exercise significant influence over the other. For the purpose of this:

(i) **Subsidiary** will have the same meaning as defined in sub-section 3(2) of the Companies Ordinance, 1984 i.e. a company or a body corporate shall deemed to be a subsidiary of another company if that other company or body corporate directly or indirectly controls, beneficially owns or holds more than 50% of its voting securities or otherwise has power to elect and appoint more than 50% of its directors.

(ii) **Control** refers to an ownership directly or indirectly through subsidiaries, of more than one half of voting power of an enterprise.

(iii) **Substantial ownership / affiliation** means beneficial share holding of 10% by a person and/or by his family members including spouse, lineal ascendants and descendants and brothers and sisters.

(iv) **Significant influence** refers to the management control of the company, to participate in financial and operating policies, either exercised by representation in the Board of Directors, partnership or by statute / agreement in the policy making process or affiliation or material inter- company transactions.

(j) **Liquid Assets** are the assets which are readily convertible into cash without recourse to a court of law and mean encashment / realizable value of government securities, bank deposits, shares of listed companies which are actively traded on the stock exchange, NIT Units, certificates of mutual funds, Certificates of Investment (COIs)/Certificates of Deposits (CODs) issued by DFIs / NBFCs and Certificates of Musharika (COMs) issued by Modarabas rated at least 'A' by a credit rating agency registered with the SEC, listed TFCs and Commercial Papers rated at least 'A' by a credit rating agency registered with the SEC, National Saving Scheme securities and units of open ended schemes for which a duly licensed asset management company quotes daily offer and bid rates. These assets with appropriate margins should be in possession of the NBFCs with perfected lien.

(k) **Major Shareholder** of a NBFC means any person holding 10% or more of the share capital of a NBFC either individually or in concert with family members.

(l) **Medium and Long Term Facilities** mean facilities with maturities of more than one year.

(m) **Other Form of Security** means hypothecation of stock (inventory), assignment of receivables, lease rentals, contract receivables, etc.

(n) **Readily Realizable Assets** include liquid assets and stocks pledged with the NBFCs and are in their possession, with 'perfected lien' duly supported with complete documentation.

(o) **Rentals** include lease rentals, rentals in respect of housin g finance facilities, hire purchase installments or any other amount received by NBFC from borrower against the grant of facility.

(p) **Short Term Facilities** mean facilities with maturities up to one year

(q) **Subordinated Loan** means an unsecured loan extended to the borrower by its sponsors, subordinate to the claim of the NBFC taking exposure on the borrower and documented by a formal sub-ordination agreement between provider of the loan and the borrower. The loan shall be disclosed in the annual audited financial statements of the borrower as subordinated loan.

(r) **Tangible Security** means readily realizable assets, mortgage of land, plant, building, machinery and any other fixed assets.

(s) **Underwriting Commitments** mean commitments given by NBFCs to the limited companies at the time of new issue of equity / debt instrument, that in case the proposed issue of equity/debt instrument is not fully subscribed, the un-subscribed portion will be taken up by them (NBFCs).

(2) All terms and expressions used but not defined in these regulations shall have the same meanings as assigned to them in the Non-Banking Finance Companies (Establishment & Regulation) Rules, 2003.

(3) Part – II & III of these regulations shall not apply to NBFCs operating solely or in any combination thereof, as an asset management company, investment advisor or a venture capital company. However, Part – IV of these regulations shall apply to all NBFCs undertaking any form of business mentioned in section 282A of the Companies Ordinance, 1984.

PART – II

(A) Corporate Borrowers

1. Limit on NBFC's exposure to a single person. -(1) The total outstanding exposure by a NBFC to any single person shall not at any point in time exceed 30% of the NBFC's equity (as disclosed in the latest audited financial statements), subject to the condition that the maximum outstanding against fund based exposure does not exceed 20% of the NBFC's equity.

(2) The total outstanding exposure by a NBFC to any group shall not exceed 50% of the NBFC's equity (as disclosed in the latest audited financial statements), subject to the condition that the maximum outstanding against fund-based exposure does not exceed 35% of the NBFC's equity.

(3) In arriving at exposure under this Regulation:

a) 100% of the deposits placed with lending NBFC and TFCs, having investment grade credit rating by a rating agency registered with the SEC, of the lending NBFC shall be excluded.

b) 90% of the following shall be deducted;

(i) deposits with another financial institution under perfected lien;

(ii) encashment value of Government Securities and National Saving Scheme securities, lodged by the borrower as collateral; and

(iii) Pak. Rupee equivalent of face value of Special US Dollar Bonds converted at inter-bank rate, lodged by the borrower as collateral.

c) 85% of the unconditional financial guarantees, payable on demand, issued by a financial institution rated at least 'A' by a credit rating agency registered with the SEC, accepted as collateral by NBFCs shall be deducted.

d) 75% of listed Term Finance Certificates held as security with duly marked lien shall be deducted. The TFCs to qualify for this purpose should have been rated at least 'A' or equivalent by a credit rating agency registered with the SEC.

e) Weightage of 50% shall be given to;

(i) guarantees / bonds other than financial guarantees;

(ii) underwriting commitments.

f) The following different weightages will be applicable to exposure taken against financial institutions in respect of placements;

(i) 10% weightage on exposure to financial institutions with 'AAA' rating.

(ii) 25% weightage on exposure to financial institutions rated 'A' and above.

(iii) 50% weightage on exposure to financial institutions rated 'BBB' and above.

(4) For the purpose of this regulation, exposure shall not include the following:

(i) Obligations under letters of credit and letters of guarantee to the extent of cash margin held by the NBFCs.

(ii) Letters of credit, which do not create any obligation on the part of the NBFCs (no liability L/C) to make payments on account of imports.

(iii) Facilities provided to financial institutions through REPO transactions with underlying SLR eligible securities

(iv) Pre-shipment / post-shipment credit provided to finance exports of goods covered by letter of credit/firm contracts including financing provided from the NBFC's own resources.

(v) Letters of credit established for the import of plant and machinery.

2. **<u>Minimum conditions for grant of financing facilities.</u> -** (1) When considering proposals for fund/non-fund based facility exceeding one million rupees, NBFCs should give due weightage to credit report relating to the borrower and his group obtained from Credit Information Bureau of the State Bank of Pakistan. If the credit report indicates over-exposure/default, the facilities shall be extended only after recording reasons to do so.

(2) While granting any facility to the customers other than individuals, NBFC shall obtain copy of accounts relating to the business of each of its borrower for analysis and record in the following manner, namely:-

(a) where the exposure does not exceed one million rupees.	Such documentary evidence of the means and investment of the borrower as may be determined by the management of the NBFC.
(b) where the exposure exceeds one million rupees but does not exceed two million rupees	Accounts duly signed by the borrower
(c) where exposure exceeds two million rupees but does not exceed ten million rupees.	Accounts duly signed by the borrower and counter signed by: (i) a chartered accountant; or (ii) a cost and management accountant in case of a borrower other than a public company or a private company which is a subsidiary of a public company.
(d) where the exposure exceeds ten million rupees	Accounts duly audited by: (i) a practicing chartered accountant; or (ii) a practicing cost and management accountant in case of a borrower other than a public company or a private company which is a subsidiary of a public company.
Explanation: In case of individuals, NBFC shall obtain such documentary evidence of the means and investment of the borrower such as wealth statement, statement of assets and liabilities or any other statement as may be considered appropriate by the management of the NBFC.	

(3) Every NBFC shall, before providing any facility (including renewal, enhancement and rescheduling/restructuring), ensure that the Loan Application Form prescribed/devised by a NBFC is accompanied with a “Borrower’s Basic Fact Sheet” as per Annexure-I. NBFC shall also ensure that the information requested in the Basic Fact Sheet is provided by the borrower under his seal and signature.

3. Linkage between a borrower's equity and total exposure from financial institutions. – (1) While taking any exposure, NBFCs shall ensure that the total exposure availed by any borrower from financial institutions does not exceed 10 times of borrower's equity as disclosed in its financial statements.

2) For the purpose of this regulation, subordinated loans shall be counted as equity of the borrower. NBFCs should specifically include the condition of subordinated loan in their Offer Letter. The subordination agreement to be signed by the provider of the subordinated loan, should confirm that the subordinated loan will be repaid after that NBFC's prior approval.

4. Financial indicators of the borrowers: - (1) It is expected that at the time of allowing fresh exposure / enhancement / renewal, the debt-equity ratio of the borrower does not exceed 60:40 and current assets to current liabilities ratio is not lower than 1:1 or any other ratios as may be prescribed by the Commission from time to time. Current maturities of long term debt not yet due for payment may be excluded from the current liabilities and lease rentals receivable within the next twelve months as disclosed in the annual audited accounts shall be treated as current assets for the purpose of calculating current assets to current liabilities ratio. However, in exceptional cases, NBFCs may relax these ratios in case of facilities upto three million rupees, if they are satisfied that appropriate risk mitigants have been put in place. Where the NBFCs have taken exposure on exceptional basis as provided above, they shall record in writing the reasons and justifications for doing so in the approval form and maintain a file in their central credit office containing all such approvals. The Exceptions Approval file shall be made available to the inspection team of the SEC during the inspection.

2) This regulation shall not apply to the facilities granted to financial institutions with investment grade rating by a credit rating agency registered with SEC or in case of exposure fully secured against liquid assets held as collateral. Export finance and finance provided to ginning and rice husking factories shall also be excluded from the borrowings (exposure) for the purpose of this regulation.

5. Margin against facilities. - (1) Following minimum margins shall be maintained against various facilities and all guarantees will be backed by 100% realizable securities:

(a) In case of performance bonds, the condition of 100% cover of realizable securities may be relaxed subject to minimum compulsory realizable security cover equivalent to 20% of the amount of the performance bond;

(b) In case of guarantees issued against mobilisation advance, the condition of 100% cover of realizable securities may be relaxed subject to the following conditions, namely:

(i) Guarantees issued shall contain a clause that the mobilisation advance shall be released by the beneficiary through the guarantor NBFC only; and

(ii) At the time of issuing such a guarantee the beneficiary shall sign an agreement with the NBFC that releases out of mobilisation advance would be covered by realizable assets; and

(c) In case of bid bonds issued on behalf of domestic consultancy firms bidding for international contracts where the consultancy fees are to be received in foreign exchange, the requirement of 100% cover by realizable securities may be waived off, and this relaxation would also be available to all suppliers of goods and services bidding against international tenders.

(2) NBFCs shall adhere to the following margin requirements:

i. Shares of listed Companies /TFCs	As at Regulation 6 of Part-II
ii. Bank deposits and Certificates of Investment / Certificates of Deposit of NBFCs/DFIs and Certificates of Musharaka of Modarabas with investment grade credit rating by a credit rating agency registered with SEC. • 25% margin is applicable to all forms of certificates including certificates issued under National Saving Scheme such as (a) Special Saving Certificate (b) Khas Deposits Certificates(c) Defense Saving Certificates (d) Foreign Exchange Bearer Certificates (e) Any other Government backed securities. • Value of such certificates shall be taken as the sum payable on the date when facility is being granted by the NBFCs. • Prize Bonds being issued by Government needs to be given same treatment as that of other securities issued by Government. As such NBFCs can provide facilities against Prize Bonds at 25% margin or a margin of 1.5 times of accrued markup on annual basis which ever is higher. Facilities provided against Prize Bonds should be for one year.	20%
(iii) Pledge of trading stocks	25%
(iv) Hypothecation of trading stocks	50%

6. <u>Facilities against Shares/TFCs and acquisition of shares. –</u> (1) NBFCs shall not:

a) take exposure against the security of shares / TFCs issued by them.

b) provide unsecured credit to finance subscription towards floatation of share capital and issue of TFCs.

c) take exposure against the non-listed TFCs or the shares of companies not listed on the Stock Exchange(s).

d) take exposure on any limited company against the shares/TFCs of that company or its group companies.

e) take exposure against 'sponsor director's shares' (issued in their own name or in the name of their family members) of banks.

f) take exposure against the shares/TFCs of listed companies that are not members of the Central Depository System.

g) take exposure against unsecured TFCs or non-rated TFCs or TFCs rated below investment grade by a credit rating agency registered with the SEC.

2. NBFCs shall not hold shares in any company whether as pledgee, mortgagee, or absolute owner, of an amount exceeding 30% of the paid-up share capital of that company or 30% of their own paid-up share capital and reserves, whichever is less. Provided that this restriction shall not be applicable to the investments made by the NBFCs in the subsidiaries.

3. Exposure against the shares of listed companies shall be subject to minimum margin of 30% of their current market value, though the NBFCs may, if they wish, set higher margin requirements keeping in view other factors. The NBFCs will monitor the margin on at least weekly basis and will take appropriate action for top-up and sell-out on the basis of their Board of Directors' approved credit policy and pre-fact written authorization from the borrower enabling the NBFCs to do this.

4. Exposure against TFCs rated 'A' (or equivalent) and above by a credit rating agency registered with the SEC shall be subject to a minimum margin of 10% while the exposure against TFCs rated 'A-' and 'BBB' shall be subject to a minimum margin of 20%.

7. <u>Restrictions on certain types of transactions.</u> – (1) No NBFC shall allow facilities to any of its directors or to individuals, firms or companies in which it or any of its directors is interested as partner, director or guarantor, as the case may be, its chief executive and its major shareholders, including their spouses, parents, and children or to firms and companies in which they are interested as partners, directors or major shareholders of that concern without the approval by the majority of the directors of that NBFC;

Provided that the director interested in seeking such approval shall not take part in the proceedings of the approval of the facility;

(2) No NBFC shall allow unsecured facilities or facilities that are not backed by bank guarantees. Provided that the bank providing the guarantee shall have a minimum investment grade credit rating.

(3) No NBFC shall allow facilities on the guarantee of its chief executive, directors and major shareholders including their spouses, parents and children or to firms and companies in which they are interested as partners, directors or major shareholders of that concern.

(4) No NBFC shall allow facilities for speculative purposes.

(5) No NBFC other than the NBFC licensed by the SEC to undertake housing finance services shall hold or trade in real estate except that in use of the NBFC itself. Property acquired from a borrower/lessee in consequence of his failing to meet his obligations to NBFC would be exempt from this regulation.

(6) The facilities extended by NBFCs to their directors, major shareholders, employees and family members of these persons shall be at arms length basis and on normal terms and conditions applicable for other customers of the NBFCs. The NBFCs shall ensure that the appraisal standards are not compromised in such cases and market rates are used for these persons. The facilities extended to the employees of the NBFCs as a part of their compensation package under Employees Service Rules shall not fall in this category.

(B) Individuals Borrowers

8. <u>Regulations for Housing Finance for individuals</u>

1. The maximum per party limit in respect of housing finance by the NBFCs will be Rs 7.5 million.

2. NBFCs are free to extend mortgage loans for housing, for a period not exceeding twenty years (In case of facilities granted by House Building Finance Corporation the said period may be extended upto twenty five years). NBFCs should be mindful of their adequate asset liability matching.

3. The house financed by the NBFCs shall be mortgaged in NBFC's favour by way of equitable or registered mortgage.

4. NBFCs shall either engage professional expertise or arrange sufficient training for their concerned officials to evaluate the property, assess the genuineness and integrity of the title documents, etc.

5. The housing finance facility shall be provided at a maximum Loan to Value ratio of 85:100 (85%).

6. The housing finance facility shall be provided at a maximum of Income to installment ratio of 3:1.

<u>Part-III</u>

1. <u>Limit on NBFC's exposure against liabilities.</u> - (1) Liabilities, excluding contingent liabilities and security deposits, of NBFC shall not exceed seven times of its equity for the first two years of its operations. In the subsequent years, the liabilities shall not exceed ten times of the equity of the NBFC.

(2) Contingent liabilities of a NBFC shall not exceed seven times of its equity for the first two years of its operations. In the subsequent years, the contingent liabilities shall not exceed ten times of the equity of NBFC.

2. <u>Creation and building up of reserve.</u> - Every NBFC shall create reserve fund to which shall be credited:

(a) an amount not less than 20% of its after tax profits till such time the reserve fund equals the amount of the paid up capital; and

(b) thereafter a sum not less than 5% of its after tax profits.

Explanation. - Issuance of bonus shares may be made from the above-mentioned reserves or the reserves available after appropriation made under clause (a) or (b) whichever may be the case and since such bonus shares will increase the paid up capital, the NBFC shall transfer further amounts to the reserves in order to comply with condition of clause (a);

3. Return on deposits. - Every NBFI shall provide return on deposits which may be different for different volumes and maturities of deposits provided that uniformity is observed within each category but deposits of listed companies, financial institutions, recognized charitable trusts and statutory bodies shall, however, be exempt.

4. Deposit Insurance. – When deposit insurance arrangements are in place, every NBFC shall arrange full insurance cover for its deposits/COIs etc. upto Rs. 100,000/-.

5. Classification and Provisioning for non-performing assets. - (1) Every NBFC shall observe the following prudential guidelines in the matter of classification of its assets and provisioning there against: -

(A) SHORT TERM FINANCING FACILITIES

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISIONS TO BE MADE
(1)	(2)	(3)	(4)
OAEM (Other Assets Especially Mentioned).	Where rental, mark-up/ interest/profit or principal is overdue (past due) by 90 days from the due date.	Unrealized mark-up/ interest/profit to be put in Suspense Account and not to be credited to Income Account except when realized in cash.	No Provision is required.
Substandard.	Where rental, mark-up/ interest/profit or principal is overdue by 180 days or more from the due date.	As above.	Provision of 20% of the difference resulting from the outstanding balance of principal against the facility less the amount of

			liquid assets realizable without recourse to a Court of Law and forced sale value of mortgaged/ pledged/ leased/ collaterally held assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
Doubtful.	Where rental, mark-up/ interest/profit or principal is overdue by one year or more from the due date.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal against the facility less the amount of liquid assets realizable without recourse to a Court of Law and forced sale value of mortgaged/ pledged/ leased/ collaterally held assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
Loss.	(a) Where rental,	As above.	Provision of

	mark-up/ interest/profit or principal is overdue beyond two years 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.	100% of the difference resulting from the outstanding balance of principal against the facility less the amount of liquid assets realizable without recourse to a Court of Law and forced sale value of mortgaged/ pledged/ leased/ collaterally held assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation. As above.

(B) MEDIUM AND LONG TERM FINANCING FACILITIES

CLASSIFICATION	**DETERMINANT**	**TREATMENT OF INCOME**	**PROVISIONS TO BE MADE**
(1)	(2)	(3)	(4)
OAEM (Other Assets Especially Mentioned).	Where rental, mark-up/ interest/profit or principal is overdue (past due) by 90 days from the due date.	Unrealized mark-up/ interest/profit to be put in Suspense Account and not to be credited to Income Account except when realized in cash.	No Provision is required.

Substandard.	Where installment of principal/ rental or interest/ mark-up/profit is overdue by one year or more.	As above.	Provision of 20% of the difference resulting from the outstanding balance of principal against the facility less the amount of liquid assets realizable without recourse to a Court of Law and forced sale value of mortgaged/ pledged/ leased/ collaterally held assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
Doubtful.	Where installment of principal/ rental or interest/ mark-up/profit is overdue by two years or more.	As above.	Provision of 50% of the difference resulting from the outstanding balance of principal against the facility less the amount of liquid assets realizable without recourse to a Court of Law and forced sale value of mortgaged / pledged / leased / collaterally held assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
Loss.	Where installment of principal/ rental or interest/ mark-up/profit is overdue	As above.	Provision of 100% of the difference resulting from the outstanding balance

	by three years or more.		of principal against the facility less the amount of liquid assets realizable without recourse to a Court of Law and forced sale value of mortgaged/ pledged / leased / collaterally held assets as valued by valuers fulfilling prescribed eligibility criteria, in accordance with the guidelines provided in this regulation.
Notes: (a) Classified facilities / loans / advances that have been guaranteed by the Government would not require provisioning, however, markup / interest / profit on such accounts shall be taken to suspense account instead of income account.			

(2) In addition to the above time based criteria, subjective evaluation of performing and non-performing advances / loans / lease port-folio shall be made for risk assessment and where considered necessary the category of classification determined on the basis of time based criteria shall be further downgraded. Such evaluation shall be carried out on the basis of adequacy of security inclusive of its realizable value, cash flow of borrower / lessee, his operation in the account, documentation covering advances and credit worthiness of the borrower / lessee etc.

(3) The rescheduling / restructuring of non-performing facilities shall not change the status of classification of a facility unless the terms and conditions of rescheduling / restructuring are fully met for a period of at least one year (excluding grace period, if any) from the date of such rescheduling / restructuring and at least 25% of the outstanding amount is recovered in cash. Accordingly, NBFCs are directed to ensure that status of classification, as well as provisioning, is not changed in relevant reports to the SEC merely because a facility has been rescheduled or restructured. However, while reporting to the Credit Information Bureau (CIB) of State Bank of Pakistan, such loans / advances may be shown as ‘rescheduled / restructured’ instead of ‘default’.

(4) Where a borrower subsequently defaults (either principal or mark-up) after the rescheduled / restructured loan has been declassified by the NBFCs as per above guidelines, the loan will again be classified in the same category it was in at the time of rescheduling / restructuring. However, NBFCs at their discretion may further downgrade the classification, taking into account the subjective criteria.

(5) At the time of rescheduling / restructuring, NBFCs shall consider and examine strictly on merit the viability of the project / business and shall appropriately secure their interest etc.

(6) NBFCs shall classify their loans / advances / lease portfolio and make provision thereagainst in accordance with the time-based criteria prescribed above. However, where a NBFC wishes to avail the benefit of leased assets owned by the NBFC; or additional collaterals held against lease facilities; or collaterals held against advances / loans facilities, they can consider the realizable value of mortgaged or pledged or leased or collaterally held assets for deduction from the outstanding principal amount of loans / advances / lease facilities against which such assets are leased/mortgaged/pledged/ collaterally held, before making any provisions. The value of the mortgaged / pledged assets, other than liquid assets, to be considered for this purpose shall be the forced sale value. Further, Forced Sale Value (FSV) once determined, shall remain valid for three years from the date of valuation during which period the underlying collateral/leased assets will not be revalued for provisioning purpose. The adjustment factors of 80%, 70% and 50% shall be applied on the value so determined for the purpose of determining provisioning requirement in 1st, 2nd and 3rd year of valuation, respectively. Thereafter, the assets shall be revalued and the adjustment factor of 50% shall be applied for all subsequent years. However, the FSV of the collateral shall be restricted to fresh revaluation or previous value, whichever is less. In case of NBCFs, duly licensed by the SEC to undertake housing finance services, FSV once determined, shall remain valid for a period of ten years from the date of valuation and an adjustment factor of 70% shall be applied on the value so determined for the purpose of determining provisioning requirement in respect of housing finance for the said period.

(7) Facilities against which securities or incase of lease facilities, additional securities are not available, or where mortgaged or pledged or leased assets have not been valued according to these guidelines and verified by the external auditors, shall continue to be classified and provided for according to the time-based criteria. NBFCs shall observe the following uniform criteria, for determining the realizable value of mortgaged / pledged / leased/ collaterally held assets, namely:-

(i) Only assets having registered mortgage, equitable mortgage (where NOC for creating further charge has not been issued by NBFC and pledged /collaterally held assets shall be considered. Assets having pari-passu charge shall be considered on proportionate basis.

(ii) Hypothecated assets and assets with second charge and floating charge shall not be considered.

(iii) Valuations shall be carried out by an independent professional valuer who should be listed on the panel of valuers maintained by the Pakistan Banks Association / Leasing Association of Pakistan. The valuers while assigning any values to the mortgaged / pledged / leased / collaterally held assets, shall take into account all relevant factors affecting the salability of such assets including any difficulty in obtaining their possession, their location and condition and the prevailing economic conditions in the relevant sector, business or industry. The realizable values of mortgaged / pledged / leased /collaterally held assets so determined by the valuers 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 valuers should also mention in their report the assumptions made, the calculations / formulae / basis used and the method adopted in determination of the realizable values.

(iv) Valuation shall be done at least once in three years. If valuation is older than three years, a fresh revaluation should be done; otherwise the valuation shall be taken as Nil. This requirement shall not be applicable to the NBFCs engaged in housing finance services.

The categories of mortgaged/pledged/leased /collaterally held assets to be considered for valuation alongwith discounting factors to be applied would be as under (no other assets shall be taken into consideration):

(a) Liquid Assets:

Valuation of Liquid Assets, excluding pledged stocks, which are dealt with at (b) below, shall be determined by the NBFC 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 and as per guidelines given in the Technical Release (TR) - 23 issued by the Institute of Chartered Accountants of Pakistan (ICAP). Moreover, valuation of shares pledged against loans/advances/lease facilities shall be considered only if these have been routed through Central Depository Company of Pakistan (CDC), otherwise these will not be admissible for deduction as liquid assets while determining required provisions.

(b) Pledged Stocks:

In case of pledged stocks of perishable and non-perishable goods, forced sale value should be provided by valuers, which should not be more than six months old, at each balance sheet date. The goods should be perfectly pledged, the operation of the godowns should be in control of the NBFC and regular valid insurance and other documents should be available. In case of perishable goods the valuers should also give the approximate date when these are expected to be of no value.

The values of mortgaged / pledged / leased / collaterally held assets determined by the valuers shall be subject to verification by the external auditors, who may reject cases of valuation, which in their opinion, do not appear to have been professionally carried out and values determined are unreasonable, or in the case of which valid documentation of mortgage / pledge / leased / collaterally held asset, supported by legal opinion wherever required, is not available on record.

(1) Subjective evaluation of investment portfolio and other assets shall be carried out by the NBFC. Classification of such assets and provision required there-against should be determined keeping in view the risk involved and the requirements of the International Accounting Standards as notified by the SEC under sub-section (3) of Section 234 of the Companies Ordinance, 1984 and Technical Releases issued by the ICAP, from time to time.

(2) NBFCs shall review, at least on a quarterly basis, the collectibility of their loans / advances / lease portfolio and shall properly document the evaluations so made. Shortfall in provisioning, if any, determined as a result of quarterly assessment, shall be provided for immediately in their books of accounts by the NBFCs.

(3) The external auditors as a part of their annual audits of NBFCs shall verify that all requirements under these regulations for classification of assets and determination of provisions required there-against have been complied with. The Commission may also check the adequacy of provisioning during on-site inspection.

7. Reversal of Provision: The provision held against classified assets will only be reversed when cash realization starts exceeding:

(i) in case of loss category, the net book value of the assets;

(ii) in case of doubtful category, 50% of the net book value of the assets; and

(iii) in case of sub-standard category, 20% of the net book value of the assets.

8. Overdue, default and recovery thereof. - (1) Every NBFC shall furnish the Commission a list of defaulters on prescribed format, on quarterly basis. A list of rescheduled and restructured facilities shall also be submitted to the Commission in the similar manner on prescribed format. A person, whether natural or juristic, shall be deemed to be defaulter if he (or his dependent family members or concerns owned or controlled by him or concerns in which he or his dependent family members are major shareholders) has failed to pay off or liquidate any fiduciary obligation towards any NBFC in Pakistan as was agreed upon or required under the terms and conditions of availment of the financing facility or to do or perform an act agreed to or undertaken in writing to be done or performed by him and such failure has continued for a period of one year from the date on which he was required to make the payment or to do or perform the act.

(2) Every NBFC shall nominate an officer as recovery officer or constitute a section as recovery section depending upon the magnitude of defaults.

(3) Besides the measures presently instituted by each NBFC, the NBFC shall set quarterly recovery targets as a percentage of the overdue obligations and communicate the same on quarterly basis to the Commission.

(4) A progress report on the recovery in relation to the targets shall be submitted to the Commission on quarterly basis. NBFC shall also be required to explain deficiency if any, in meeting the targets and the strategies evolved with a view to ensuring achievement of subsequent targets.

(5) Wherever considered legally appropriate by the NBFC, cases of default may be referred to the Courts. The list of such cases and progress of recovery shall also be sent to the Commission on a quarterly basis.

Part IV

1. Internal audit. - Every NBFC shall have an Internal Audit Department whose head shall report to the board of directors directly and shall, inter alia, be responsible for compliance with these guidelines and for establishing an effective means of testing, checking and compliance with the policy and procedures established by it.

2. Submission of statistical returns. - Every NBFC shall submit such periodical statements, information or reports in such forms and manner and within such time as may be prescribed by the Commission from time to time.

3. Code of conduct. - Every NBFC shall acquire and maintain membership of an association constituted in consultation with the Commission and NBFCs shall follow the code of conduct prescribed by the said association(s).

4. Prevention of criminal use of NBFCs for the purpose of money laundering and other unlawful trades. - NBFCs shall follow guidelines issued to safeguard themselves against their involvement in money laundering activities and other unlawful trades. These will add to or reinforce the following precautions, NBFCs may have been taking in this regard;

a) NBFCs shall accept deposits from an investor only after ensuring that an account has been opened in the investor's name using an account opening form, which will be developed by the respective industry associations in consultation with the Commission.

b) NBFCs shall make reasonable efforts to determine the true identity of the customer before extending their services and particular care shall be taken to identify ownership of all accounts and those using safe custody facilities, effective procedures shall be instituted for obtaining identification from new customers and an explicit policy shall be devised to ensure that significant business transactions are not conducted with customers who fail to provide evidence of their identity;

c) NBFCs shall ensure that business is conducted in conformity with high ethical standards and that rules and regulations are adhered to. It is accepted that a NBFC normally does not have effective means of knowing whether a transaction stems from or forms part of wrongful activity. Similarly, in an international context, it may be difficult to ensure that cross border transactions on behalf of customers are in compliance with the regulations of another country. Nevertheless, NBFCs shall not set out to offer services or provide active assistance in transactions which in their opinion are associated with money derived from illegal activities; and

d) NBFCs shall establish specific procedures for ascertaining customer status and his sources of earning for monitoring of accounts on a regular basis for checking identities and bonafides of remitters and beneficiaries, for retaining internal record of transactions for future reference. The transactions, which are out of character with the normal operation of the account involving high deposits, withdrawals and transfers, shall be viewed with suspicion and property investigated.

e) Every NBFC shall ensure that no payment or receipt exceeding Rs. 50,000/- shall be made in cash.

5. Procedure for prior approval for appointment of directors and chief executives. –

NBFCs shall, for obtaining prior approval of the Commission for making any change in the directors/chief executive, follow the following procedure:

a) The application for approval of the appointment or any change in the directors/Chief Executive of NBFCs shall be submitted by the NBFC to the Specialized Companies Division of the Commission not later than 14 days before the election/appointment or any change in the Directors/Chief Executive;

b) The above-referred application shall not be treated complete unless the information/documents as required under Form attached as Annexure-II are furnished.

c) The information or deficiency or shortcoming as pointed out by the Commission shall be supplied by the NBFC, within 14 (fourteen) days of the issue of the letter by the Commission, otherwise the matter shall be treated as having been closed.

ANNEXURE I

BORROWER'S BASIC FACT SHEET – FOR CORPORATE
PRESCRIBED UNDER REGULATION 2 OF PART - II

Date of Request. ___________

(TO BE COMPLETED IN CAPITAL LETTERS OR TYPEWRITTEN)

1. BORROWER'S PROFILE:

Name		Address	
Phone#		Fax #	Email Address
Office	Res.		
National Identity Card #		National Tax #	Sales Tax #
Import Registration #	Export Registration #	Date of Establishment	Date of opening of A/C

2. DETAILS OF DIRECTORS/OWNERS/PARTNERS:

Name		Address	
Phone#		Fax #	Email Address
Office	Res.		
National Identity Card #		National Tax #	
Shareholding	Amount	% of Shareholding	

3. MANAGEMENT:

A) EXECUTIVE DIRECTORS/PARTNERS:			
Name	Address	NIC #	Phone #
1.			
2.			
B) NON-EXECUTIVE DIRECTORS/PARTNERS:			
Name	Address	NIC #	Phone #
1.			
2.			

4. CORPORATE STATUS:

Sole Proprietorship	Partnership	Public/Private Company

5. NATURE OF BUSINESS:

Industrial	Commercial	Agricultural	Services	Any other

6. REQUESTED LIMITS:

	Amount	Tenor
Fund Based		
Non-Fund Based		

7. BUSINESS HANDLED/EFFECTED WITH ALL FINANCIAL INSTITUTIONS DURING THE LAST ACCOUNTING YEAR

Imports	Exports	Remittances effected (if any)

8. EXISTING LIMITS AND STATUS:

	Amount	Expiry date	Status	
			Regular	Amount over-due (if any)
Fund Based				
Non-Fund Based				

9. ANY WRITE-OFF, RESCHEDULING/RESTRUCTURING AVAILED DURING THE LAST THREE YEARS:

Name of Financial Institution	Amount during 1st year		Amount during 2nd year		Amount during 3rd year	
	Write-off	Rescheduled/ restructured	Write-off	Rescheduled/ restructured	Write-off	Rescheduled/ restructured

10. DETAILS OF PRIME SECURITIES MORTGAGED/PLEDGED:

A) AGAINST EXISTING FACILITIES:

Name of Financial Institution	Nature of Security	Total Amount	Rank of Charge	Net Realizable Value
1.				
2.				

B) AGAINST REQUESTED/FRESH/ADDITIONAL FACILITIES:

Name of Financial Institution	Nature of Security	Total Amount	Net Realizable Value
1.			
2.			

11. DETAILS OF SECONDARY COLLATERAL MORTGAGED/PLEDGED:

A) AGAINST EXISTING FACILITIES:

Name of Financial Institution	Nature of Security	Total Amount	Rank of Charge	Net Realizable Value
1.				
2.				

B) AGAINST REQUESTED/FRESH/ADDITIONAL FACILITIES:

Name of Financial Institution	Nature of Security	Total Amount	Net Realizable Value
1.			
2.			

12. CREDIT RATING (WHERE APPLICABLE):

Name Of Rating Agency	Rating

13. DETAILS OF ASSOCIATED CONCERNS
(AS DEFINED IN COMPANIES ORDINANCE, 1984):

Name of Concern	Name of Directors	Shareholding	% of Total shares capital

14. FACILITIES TO ASSOCIATED CONCERNS BY THE CONCERNED FI:

Name of concern	Nature & Amount of limit	Outstanding as on --------	Nature & Value of Securities	Overdues	Defaults

15. DETAILS OF PERSONAL GUARANTEES PROVIDED BY THE DIRECTORS/PARTNERS etc. TO FIs TO SECURE CREDIT:

Names of the Guarantors	Institutions/ persons to to whom Guarantee given	Amount of Guarantee	Validity Period	NIC #	NTN	Net-worth

16. DIVIDEND DECLARED (AMOUNT) DURING THE LAST THREE YEARS:

During 1st Year	During 2nd Year	During 3rd Year

17. SHARE PRICES OF THE BORROWING ENTITY:

Listed Companies		Break-up value of the Shares in case of Private Limited Company
Current Price	Preceding 12 Months Average	

18. NET-WORTH (PARTICULARS OF ASSETS OWNED IN THEIR OWN NAMES BY THE DIRECTORS/PARTNERS/PROPRIETORS):

Owner's Name	Particulars of Assets	Market Value	Particulars of Liabilities

19. DETAILS OF ALL OVER DUES (IF OVER 90 DAYS):

Name Of Financial Institution	Amount

20. Details of payment schedule if term loan sought.

21. Latest Audited Financial Statements as per requirement of Regulation 2 to be submitted with the LAF (Loan Application Form).

22. Memorandum and Articles of Association, By-laws etc. to be submitted by the borrower along with the request.

I certify and undertake that the information furnished above is true to the best of my knowledge.

CHIEF EXECUTIVE'S/BORROWER'S
SIGNATURE & STAMP

COUNTER SIGNED BY:

AUTHORIZED SIGNATURE & STAMP
(NBFC OFFICIAL)

BORROWER'S BASIC FACT SHEET – FOR INDIVIDUALS
PRESCRIBED UNDER PRUDENTIAL REGULATION 2 of PART-II

Date of Request. __________

(TO BE COMPLETED IN CAPITAL LETTERS OR TYPEWRITTEN)

1. BORROWER'S PROFILE:

Name		Address	
Phone#		Fax #	Email Address
Office	Res.		
National Identity Card #		National Tax #	
Father's Name		Father's National Identity Card #	

2. PREFERENCES (AT LEAST TWO):

Name		Address	
Phone#		Fax #	Email Address
Office	Res.		
National Identity Card #		National Tax #	

3. NATURE OF BUSINESS/PROFESSION:

Industrial	Commercial	Agricultural	Services	Any other

4. EXISTING LIMITS AND STATUS:

	Amount	Expiry date	Status		
			Regular	Amount over-due (if any)	Amount rescheduled/ restructured (if any)
Fund Based					
Non-Fund Based					

5. REQUESTED LIMITS:

	Amount	Tenor
Fund Based		
Non-Fund Based		

6. Details of payment schedule if term loan sought.
7. Latest Income Tax Form / Wealth Statement to be submitted by the borrower.

I certify and undertake that the information furnished above is true to be best of my knowledge

APPLICANT'S SIGNATURE & STAMP

COUNTER SIGNED BY:

AUTHORIZED SIGNATURE & STAMP
(NBFC OFFICIAL)

Annexure-II

FORM FOR APPROVAL OF DIRECTOR/CHIEF EXECUTIVE

S. No		Details		
1.		Curriculum Vitae/Resume containing:		
	a	Name: (former name if any):		
	b	N.I.C # (attach a copy attested by company secretary)		Attached as Annexure No.
	c	Latest photograph		Attached as Annexure No.
	d	Father's/Husband Name:		
	e	Nationality		
	f	Age:		
	g	Address:		
		i) Residential:		
		ii) Business:		
	h	National Tax #:		
	i	Present Occupation:		
	j	Qualification(s)		
		i) Educational		
		ii) Professional		
	k	Experience:		
2.		Number of share acquired/held		
3.	a	Names of companies, firms and other organizations of which he/she is a director, partner, office holder or major shareholder.		
	b	Names of companies, firms and other organizations of which he/she has been a director, partner, office holder or major shareholder during last 10-years.		
4.		CIB report issued by SBP (attach original latest CIB report) covering individual as well as group liabilities		Attached as Annexure No
5.		Date of Board of Directors' Meeting in which appointment of proposed director was approved. Attach copy of the minutes of the meeting of the Board of Directors. If the director is elected, then attach a copy of the minutes of the general meeting of the company.		Attached as Annexure No

6.	Affidavit under para 10 of the annexure to form-I of the Non-Banking Finance Companies (Establishment and Regulation) Rules, 2003 (attach in original).		Attached as Annexure No
7.	A copy of Checklist as circulated by the SEC vide Circular No. 8 of 2003 dated 28-2-2003		Attached as Annexure No
8.	Names of persons related to the proposed director/Chief Executive in terms of rule 7(2)(a) of NBFCs Rules who are already on the Board of the NBFC or proposed to be appointed as such and their relationship		
9.	Bank Challan # ______ dated _____________ (attach in original).		Attached as Annexure No