



**SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SPECIALIZED COMPANIES DIVISION
NBFC DEPARTMENT**

SECP/NBFC(1)/(R)/2005

Islamabad, January 09, 2006

CIRCULAR NO. 1 OF 2006

PRUDENTIAL REGULATIONS FOR CONSUMER FINANCING FOR NON-BANKING FINANCE COMPANIES ("NBFCs")

The Securities and Exchange Commission of Pakistan (SECP), in exercise of powers conferred under section 282 D of the Companies Ordinance, 1984 (the "Ordinance") hereby directs all Non-Banking Finance Companies licensed to undertake the business of Investment Finance Services, Leasing, Housing Finance Services, and Discounting Services to conduct their consumer finance business in conformity with the directions / regulations enclosed herewith as 'Prudential Regulations for Consumer Financing' (the "Regulations"). These Regulations shall be effective from January 09, 2006.

The objective behind the issuance of these Regulations is to expand the product range of these NBFCs. NBFCs engaged in Investment Finance Services, Leasing, Housing Finance Services and Discounting are advised to ensure circulation of these Regulations among all their officers / branches for meticulous compliance in both letter and spirit. Any violations or circumvention of these Regulations shall be dealt with under the provisions of the Ordinance.

In case of clarifications, please contact the following:

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These Regulations have also been placed on SECP's Website www.secp.gov.pk for information of the concerned quarters and general public.

Kindly acknowledge receipt.

(Salman Ali Shaikh)
Commissioner

Distribution:

1. Chief Executives of all Investment Banks, Leasing Companies, Housing Finance Companies, Discount Houses
2. The Chairman, Investment Banks Association of Pakistan
3. The Chairman, Leasing Association of Pakistan
4. The President, Institute of Chartered Accountants of Pakistan
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PRUDENTIAL REGULATIONS FOR CONSUMER FINANCING

Issued on January 9, 2006

**Non-Banking Finance Companies Department
Specialized Companies Division
Securities & Exchange Commission of Pakistan**

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PART – A

DEFINITIONS

Definitions. In these regulations, unless there is anything repugnant in the subject or context:

1. **Borrower** means an individual to whom a NBFC has allowed any consumer financing during the course of business.
2. **Consumer Financing** means any financing allowed to individuals for meeting their personal, family or household needs. The facilities categorized as Consumer Financing are given as under:
 - a. **Credit Cards** mean cards which allow a customer to make payments on credit. Supplementary credit cards shall be considered part of the principal borrower for the purposes of these regulations. The regulations for credit cards shall also be applicable on charge cards, debit cards, stored value cards and BTF (Balance Transfer Facility).
 - b. **Personal Loans** mean the loans to individuals for the payment of goods, services and expenses.
3. **Documents** include vouchers, cheques, bills, pay-orders, promissory notes, securities for leases / advances and claims by or against the NBFC or other papers supporting entries in the books of a NBFC.
4. **Equity of the NBFC** means equity as defined in the Non-Banking Finance Companies (Establishment & Regulation) Rules, 2003.
5. **Financial Institutions** includes:
 - 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 authorized by law to undertake any similar business, as the Federal Government may, by notification in the official Gazette, specify for the purpose.
6. **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 SECP, 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. Guarantees issued by NBFCs / DFIs / Banks rated at least 'A' by a credit rating agency registered with the SECP, when received as collateral by NBFCs will be treated at par with liquid assets whereas, for guarantees issued by foreign banks, the issuing bank's rating, assigned either by Standard & Poors, Moody's or Fitch-Ibca, should be 'A' and above or equivalent. These assets with appropriate margins should be in possession of the NBFCs with perfected lien.

7. **NBFC** means Non-Banking Finance Company and includes a Modaraba, Leasing Company, Housing Finance Company, Investment Bank, Discount House, Asset Management Company and a Venture Capital Company or any other entity notified by the Securities & Exchange Commission of Pakistan from time to time.
8. **Secured** means exposure backed by tangible security with appropriate margins (in cases where margin has been prescribed by SECP, appropriate margin shall at least be equal to the prescribed margin). Exposure without any tangible security is defined as clean.
9. **Tangible Security** means liquid assets (as defined in these Prudential Regulations), mortgage of land and building, hypothecation or charge on vehicle, but does not include hypothecation of household goods, etc.

PART – B

MINIMUM REQUIREMENTS FOR CONSUMER FINANCING

Apart from the specific regulations given under each mode of financing separately, general requirements laid down here should also be followed while undertaking consumer financing. It may be noted that these are the minimum requirements and should not in any way be construed to restrict the role of the management of the NBFCs to further strengthen the risk management processes through establishing comprehensive credit risk management systems appropriate to their type, scope, sophistication and scale of operations. The Board of Directors of the NBFCs are required to establish policies, procedures and practices to define risks, stipulate responsibilities, specify security requirements, design internal controls and then ensure strict compliance with them.

PRE-OPERATIONS:

Before embarking upon or undertaking consumer financing, the NBFCs shall implement / follow the guidelines given below.

1. NBFCs shall establish separate Risk Management function for the purpose of consumer financing, which will be suitably staffed by personnel having sufficient expertise and experience in the field of consumer finance / business.
2. The NBFCs shall prepare comprehensive consumer credit policy duly approved by their Board of Directors which shall inter alia cover loan administration, including documentation, disbursement and appropriate monitoring mechanism. The policy shall explicitly specify the functions, responsibilities and various staff positions' powers / authority relating to approval / sanction of consumer financing facility.
3. For every type of consumer finance activity, the NBFC shall develop a specific program. The program shall include the objective / quantitative parameters for the eligibility of the borrower and determining the maximum permissible limit per borrower.
4. NBFCs shall put in place an efficient computer based MIS for the purpose of consumer finance, which should be able to effectively cater to the needs of consumer financing portfolio and should be flexible enough to generate necessary information reports used by the management for effective monitoring of the NBFC's exposure in this segment.
 - a. Reports interrelating delinquencies with various types of customers or various attributes of the customers to enable the management to take important policy decisions and make appropriate modifications in the lending program.
 - b. Quarterly product wise profit and loss account duly adjusted with the provisions on account of classified accounts. These profit and loss statements should be placed before the Board of Directors in the immediate next Board Meeting. The branches of foreign banks in order to comply with this condition shall place the reports before a committee comprising of CEO / Country Manager, CFO and Head of Consumer Business.
5. The NBFCs shall develop comprehensive recovery procedures for the delinquent consumer loans. The recovery procedures may vary from product to product. However, distinct and objective triggers should be prescribed for taking pre-planned enforcement / recovery measures.
6. The NBFCs desirous of undertaking consumer finance will become a member of at least one Consumer Credit Information Bureau. Moreover, the NBFCs may share information /

data among themselves or subscribe to other databases as they deem fit and appropriate.

7. The NBFCs starting consumer financing are encouraged to impart sufficient training on an ongoing basis to their staff to raise their capability regarding various aspects of consumer finance.
8. The NBFCs shall prepare standardized set of borrowing and recourse documents (duly cleared by their legal counsels) for each type of consumer financing.

OPERATIONS:

1. Consumer financing, like other credit facilities, must be subject to the NBFC's risk management process for this particular business. The process may include, identifying source of repayment and assessing customers' ability to repay, his / her past dealings with the NBFC, the net worth and information obtained from a Consumer Credit Information Bureau.
2. At the time of granting facility under various modes of consumer financing, NBFCs shall obtain a written declaration from the borrower divulging details of various facilities already obtained from other NBFCs. The NBFCs should carefully study the details given in the statement and allow fresh finance / limit only after ensuring that the total exposure in relation to the repayment capacity of the customer does not exceed the reasonable limits as laid down in the approved policies of the NBFC. The declaration will also help NBFCs to avoid exposure against a person having multiple facilities from different financial institutions on the strength of an individual source of repayment.
3. Before allowing any facility, the NBFCs shall preferably obtain credit report from the Consumer Credit Information Bureau of which they are a member. The report will be given due weightage while making credit decision.
4. Internal audit and control function of the NBFC, apart from other things, should be designed and strengthened so that it can efficiently undertake an objective review of the consumer finance portfolio from time to time to assess various risks and possible weaknesses. The internal audit should also assess the adequacy of the internal controls and ensure that the required policies and standards are developed and practiced. Internal audit should also comment on the steps taken by the management to rectify the weaknesses pointed out by them in their previous reports for reducing the level of risk.
5. The NBFCs shall ensure that any repayment made by the borrower is accounted for before applying mark-up on the outstanding amount.

DISCLOSURE / ETHICS:

The NBFCs must clearly disclose, all the important terms, conditions, fees, charges and penalties, which interalia include Annualized Percentage Rate, prepayment penalties and the conditions under which they apply. For ease of reference and guidance of their customers, NBFCs are encouraged to publish brochures regarding frequently asked questions. For the purposes of this regulation, Annualized Percentage Rate means as follows:

$$\frac{\text{Mark-up paid for the period}}{\text{Outstanding Principal Amount}} \times \frac{360}{\text{No. of Days}} \times 100$$

PART – C

REGULATIONS FOR CONSUMER FINANCING

REGULATION - 1 FACILITIES TO RELATED PERSONS

The consumer finance facilities extended by NBFCs to their employees and their family members 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.

REGULATION - 2 LIMIT ON EXPOSURE AGAINST TOTAL CONSUMER FINANCING

NBFCs shall ensure that the aggregate exposure under all consumer financing facilities at the end of first year and second year of the start of their consumer financing does not exceed 2 times and 4 times of their equity respectively. For subsequent years, following limits are placed on the total consumer financing facilities:

PERCENTAGE OF CLASSIFIED CONSUMER FINANCING TO TOTAL CONSUMER FINANCING	MAXIMUM LIMIT
a) Below 3%	7 times of the equity
b) Below 5%	5 times of the equity
c) Below 10%	2 times of the equity
d) Upto and above 10%	1 times of the equity

REGULATION - 3 TOTAL FINANCING FACILITIES TO BE COMMENSURATE WITH THE INCOME

While extending financing facilities to their customers, the NBFCs should ensure that the total installment of the loans extended by the financial institutions is commensurate with monthly income and repayment capacity of the borrower. This measure would be in addition to NBFC's usual evaluations of each proposal concerning credit worthiness of the borrowers, to ensure that the NBFC's portfolio under consumer finance fulfills the prudential norms and instructions issued by Securities & Exchange Commission of Pakistan and does not impair the soundness and safety of the NBFC itself.

REGULATION - 4 GENERAL RESERVE AGAINST CONSUMER FINANCE

The NBFCs shall maintain a general reserve at least equivalent to 1.5% of the consumer portfolio which is fully secured and 5% of the consumer portfolio which is unsecured, to protect them from the risks associated with the economic cyclical nature of this business. The above reserve requirement will, however, be maintained for the performing portion of the consumer portfolio.

REGULATION - 5 BAR ON TRANSFER OF FACILITIES FROM ONE CATEGORY TO ANOTHER TO AVOID CLASSIFICATION

The NBFCs shall not transfer any loan or facility to be classified, from one category of consumer finance to another, to avoid classification.

REGULATION - 6
MARGIN REQUIREMENTS

NBFCs are free to determine the margin requirements on consumer facilities provided by them to their clients taking into account the risk profile of the borrower(s) in order to secure their interests.

NBFCs will continue to observe margin restrictions on shares / TFCs as per PR 5 and 6 of Part II of Prudential Regulations for Non-Banking Finance Companies.

PART – D

REGULATIONS FOR CREDIT CARDS

REGULATION - 1 **SAFE CUSTODY**

The NBFCs should take reasonable steps to satisfy themselves that cardholders have received the cards, whether personally or by mail. The NBFCs should advise the card holders of the need to take reasonable steps to keep the card safe and the PIN secret so that frauds are avoided.

REGULATION - 2 **STATEMENT OF ACCOUNTS**

NBFCs shall provide to the credit card holders, the statement of account at monthly intervals, unless there has been no transaction or no outstanding balance on the account since last statement.

REGULATION – 3 **UNAUTHORIZED / WRONG TRANSACTIONS**

NBFCs shall be liable for all transactions not authorized by the credit card holders after they have been properly served with a notice that the card has been lost / stolen. However, the NBFC's liability shall be limited to those amounts wrongly charged to the credit card holder's account. In order to mitigate the risks in this respect, the NBFCs are encouraged to take insurance cover against wrongly charged amounts, frauds, etc.

REGULATION – 4 **PARTIAL PAYMENT BY CARD HOLDER**

In case the cardholders make partial payment, the NBFCs should take into account the partial payment before charging service fee / mark-up amount on the outstanding / billed amount so that the possibility of charging excess amount of mark-up could be avoided.

REGULATION – 5 **DUE DATE FOR PAYMENT**

Due date for payment must be specifically mentioned on the accounts statement. If fine / penalty is agreed to be charged in case the payment is not made by the due date, it should be clearly mentioned in the agreement.

REGULATION – 6 **MAXIMUM CARD LIMIT**

Maximum unsecured limit under credit card to a borrower (supplementary cards shall be considered part of the principal borrower) shall generally not exceed Rs.500,000/-. NBFCs may, however, assign a clean limit beyond Rs.500,000 but not in excess of Rs.1 million to their prime customers who have extraordinary strong repayment capacity, moderate debt burden and a clean track record. But the aggregate outstanding in this respect should not exceed 10% of the total outstanding credit card portfolio at any point in time. However, while availing benefit of this provision, NBFCs would place on record well defined criteria for terms "Prime Customers" and "Moderate Debt Burden" approved by their Board of Directors / Chief Executive.

NBFCs may also allow financing under the credit card scheme in excess of Rs.500,000/- to other customers as well, provided the excess amount is appropriately secured by any tangible security as per PR 5 of Part II of Prudential Regulations for Non-Banking Finance Companies. The loan secured against liquid securities shall, however, be exempted from the above limit.

For Charge Cards, pre-set spending limits generated by standardized systems, as is the global practice, shall be allowed.

REGULATION - 7

CLASSIFICATION AND PROVISIONING

The credit card advances shall be classified and provided for in the following manner:

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISION TO BE MADE *
(1)	(2)	(3)	(4)
Loss.	Where markup / interest or principal is overdue by 180 days or more from the due date.	Unrealized markup / interest to be put in Suspense Account and not to be credited to Income Account except when realized in cash.	Provision of 100% of the difference resulting from the outstanding balance of principal less the amount of liquid securities with the NBFC.

***This specific provision will be in addition to general reserve maintained under Regulation 4. OF Part – C (General Reserve Against Consumer Finance)**

It is clarified that the lenders are allowed to follow more conservative policies. Further, provisioning may be created and maintained by the NBFC on a portfolio basis provided that the provision maintained by the NBFC shall not be less than the level required under this Regulation.

PART - E

REGULATIONS FOR PERSONAL LOANS

REGULATION – 1 PER PARTY LIMIT

The clean limit per person for personal loans will generally not exceed Rs.500,000/-. NBFCs may assign a clean limit beyond Rs.500,000 but not in excess of Rs.1 million to their prime customers who have extraordinary strong repayment capacity, moderate debt burden and a clean track record. But aggregate outstanding in this respect should not exceed 10% of the total outstanding personal loans at any point in time. However, while availing benefit of this provision, NBFCs would place on record well defined criteria for terms "Prime Customers" and "Moderate Debt Burden" approved by their Board of Directors / Chief Executive.

NBFCs may also allow financing under Personal Loans in excess of Rs.500,000 to other customers as well, provided the loan is appropriately secured by any tangible security as per PR 5 of Part II of Prudential Regulations for Non-Banking Finance Companies.

The loan secured against liquid securities shall, however, be exempted from this limit.

REGULATION 2 HYPOTHECATION

In cases, where the loan has been extended to purchase some durable goods / items, including personal computers and accessories thereof, the same will be hypothecated with the NBFC besides other securities, which the NBFC may require on its own.

REGULATION - 3 MAXIMUM TENOR OF LOAN

The maximum tenor of the loan shall not exceed 5 years. However, this period may be extended to 7 years for loans / advances given for educational purposes, provided that disbursement of such loans shall directly be made by the NBFC to the educational institution and the borrower shall not be allowed to utilize / withdraw cash directly from the NBFC under this head for any other purpose.

REGULATION – 4 MINIMUM REPAYMENT

NBFCs shall ensure that the aggregate cumulative monthly installments paid by the borrower must at least repay 15% of the maximum utilization of the loan during the year.

RREGULATION – 5
CLASSIFICATION AND PROVISIONING

The personal loans shall be classified and provided for in the following manner:

CLASSIFICATION	DETERMINANT	TREATMENT OF INCOME	PROVISION TO BE MADE *
(1)	(2)	(3)	(4)
1. Substandard.	Where markup/ interest or principal is overdue (past due) by 90 days from the due date.	Unrealized markup/ interest to be put in Suspense Account and not to be credited to Income Account except when realized in cash.	No provision is required.
2. Doubtful.	Where markup/ interest or principal is overdue by 180 days or more from the due date.	As above.	Provision of 50% of the principal amount less the amount of liquid securities with the NBFC.
Loss.	Where markup/ interest or principal is overdue by one year or more from the due date.	As above.	Provision of 100% of the principal less the amount of liquid securities with the NBFC.

*This specific provision will be in addition to general reserve maintained under Regulation 4. OF Part – C (General Reserve Against Consumer Finance)