

# State Bank of Pakistan

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## Infrastructure, Housing & SME Finance Department

### Frequently Asked Questions - Prudential Regulations for SME Financing

#### **SME Definition Regulation SE R-1 and ME R-1**

1. Which criterion (turnover or no. of employees) supersedes the other for defining the business entity?

**Clarification:** Out of both employees and turnover criterion, there is no superseding criterion.

2. A business entity having 55 employees and sales turnover of Rs 70 Million will be categorized as Small Enterprise (SE) or Medium Enterprise (ME)?

**Clarification:** The entity will be categorized as ME. In this regard, clarification has already been provided in amended PRs (issued in May, 2016).

3. An obligor with 45 employees and sales turnover of Rs. 845 Million will be categorized as SE or ME or corporate/commercial?

**Clarification:** The entity will be categorized as corporate/commercial concern.

4. A trading business entity having 120 employees but sales turnover of Rs. 350 Million will be categorized in which category SE, ME or corporate/commercial?

**Clarification:** The entity will be categorized as corporate/commercial concern.

5. How will the number of employees be determined? Should this be included in the BBFS?

**Clarification:** It is responsibility of the bank/DFI to ascertain the number of employees of their prospective SME borrowers. There is no column in both the SE & ME BBFS, which calls for information on number of employees of borrowing entity.

6. What is the minimum period for contractual employees to be eligible for inclusion as part of number of employees for SE or ME as in certain sectors, labor or supervisors are hired on seasonal basis only?

**Clarification:** Under SME PRs, no minimum service period has been prescribed for contractual employees. In case where the number of employees fluctuates, maximum number of employees during the year (including contract employees) will be taken.

#### **Regulation SE R-3 and ME R-4: Requirement of Audited Accounts**

1. Can Wealth Tax or Income Tax returns of SE or ME individuals replace the requirement of Balance Sheet?

**Clarification:** Wealth tax or IT returns cannot replace the requirement of Balance Sheet as prescribed under SME Regulation ME R-4.

### **Regulation SME R-6: Restriction on Facilities to Related Parties**

1. Whether any SME loan, secured or unsecured, can be allowed to Bank staff or their blood relatives/ spouses such as parents, brothers, sisters, if they are not depending on the bank staff?

**Clarification:** The term “family member” has been defined in sub-section (ff) of Section 5 of Banking Companies Ordinance 1962, which states that “family members in relation to a person mean his spouse, dependent lineal ascendants and descendants and dependent brothers and sisters”. Therefore, independent lineal ascendants and descendants and independent brothers and sisters of employees who are not included in the definition of “family member” may be granted financing facilities if they provide the prescribed undertaking to the bank regarding non-existence of any interest between the borrower and the bank employee as related parties.

2. Can a Bank grant unsecured loans on the guarantee of a spouse of an employee of the Bank?

**Clarification:** As per SME R-6 “The banks/DFIs shall not take any exposure on an SME in which any of its director, major shareholder holding 5% or more of the share capital of the bank/DFI or its Chief Executive, or an Employee or any family member of these persons is interested, except as specified in section 24 of the BCO, 1962. In this regard, it will, however, suffice if banks/DFIs obtain an undertaking from the Small Enterprise stating that there is no existence of any interest between the borrower and the above-mentioned related parties.”

Section 24 of BCO 1962 referred in above Regulation specifies restriction regarding loans and advances against the securities of own shares of banking companies or unsecured advances against the guarantee of any of its directors or any family member of any of its directors of banking companies. Section 24 does not contain any instructions or restrictions regarding loans and advances to the bank employees and their dependent family members. Hence, bank can grant unsecured loans on the guarantee of spouse of a bank employee.

### **Regulation SME R-7: Translation of Loan Documents into Urdu**

1. Will Urdu version of loan documents be provided to the customers on demand basis only and not mandatorily?

**Clarification:** In terms of Regulation SME R-7, Banks/DFIs should make available to their SME borrowers, the Loan Application Form, BBFS and other related documents, except charge documents, in Urdu as well. However, it will be incorrect to construe that the Urdu version of documents should be provided to the customers on demand only.

2. If both sets of documents (English & Urdu) are provided to customer for better understanding, should the Bank obtain signatures on Urdu version of documents as well, where provided?

**Clarification:** The matter of getting signature on either one set of documents or both sets of documents (English & Urdu Version) has been left to the discretion of the bank.

### Regulation SME R- 9 (General measures)

1. **As per SME R-9 Para i**, "Pricing policy of banks/DFIs that include mark-up rates (including the IRR on the loan products), processing & documentation fee, prepayment/ late-payment penalties etc. shall be mentioned explicitly in the loan agreements, i.e. the banks shall strictly avoid imposing any hidden charges in addition to those explicitly stated in the loan agreement".

The loan processing fee, charges on valuation of property, search report, credit worthiness report, stock inspection are incurred prior to sanction of loan i.e. these are already in the knowledge of customer at the time of sanction of loan. Besides, processing fee is also included in schedule of charges. Whether the requirement of regulation SME R-9 Para i is met if bank only mentions "documentation fee" in its facility letter?

**Clarification:** Para i of Regulation SME R-9 emphasize the need for proper disclosure on pricing policy and various fees/charges/penalties that may be received by the banks/DFIs from their borrowers. The various fees/charges as mentioned in above query are although incurred before the approval of facility, yet they still need to be included in the loan agreement documents and mentioned as "already incurred/recovered" from the borrower.

### Regulations SE R-2 and ME- R 3: Per Party Exposure Limit

2. What will be the treatment of a customer which falls under SE category but intends to avail exposure of above Rs. 25 million?

**Clarification:** Borrower falling under the definition of SE may be allowed higher credit limits, if the bank/DFI is satisfied to extend them higher loan limit. However, such an exposure will be governed under PRs for ME Financing.

3. What will be the treatment of a customer which falls under ME category but intends to avail exposure of above Rs. 200 million?

**Clarification:** Borrowers falling under the definition of ME may be allowed higher credit limits, if the banks/DFIs are satisfied to extend them higher loan limit. In this case, when the exposure is above Rs 200 million, then the subject loan portfolio will be governed under SBP PRs for Corporate/Commercial Banking.

4. Which criteria will supersede the other: the definition of SE/ME or the maximum exposure taken on the company?

**Clarification:** Criteria of definition and maximum exposure limit do not supersede each other. Banks can allow higher exposure limits to entities meeting the definition of SE or ME, however, in such cases, those PRs will be applicable under which the said higher per party exposure limit is covered/allowed.

5. If a loan is allowed to trading ME under PRs for ME Financing and during currency of the loan, either sales of the trading concern fall below PKR 150 million or number of employees falls below 100 (any one of two criterion is violated ), how will the case be treated?

**Clarification:** The subject business entity loan will still be categorized under ME portfolio till expiry of the loan period. Thereafter, for renewal of limit, the category of entity will be determined afresh in the light of number of employees and sales criteria.

6. Are the defined exposures of Rs.25 million in SE and Rs.200 million in ME inclusive of Non-Fund based limits or they just represent the fund based exposures?

**Clarification:** The term exposure as defined in Annexure VII of the revised SME PRs includes both financing facilities i.e. fund based and/or non-fund based. Hence, per party exposure limit as prescribed under Regulations SE R- 2 and ME R-3 respectively includes both the fund based as well as non fund based exposures.

**Miscellaneous Query:**

1. Do the PRs for SME Financing require maintenance of current ratio and debt equity ratio?

**Clarification:** PRs for SME do not require maintenance of current ratio and debt equity ratio.

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