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Housing Finance Companies

A Primer on Housing Finance and Guide to Licensing of HFCs in Pakistan

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Introduction

Licensed private sector Housing Finance Companies (HFCs) are a new feature of Pakistan's finance sector. The purpose of this handbook is to provide interested individuals and firms with information about the potential for housing finance and the process for obtaining a license to operate an HFC.

HFCs are non-banking financial institutions that are licensed as companies under the Companies Ordinance (1984) and as Housing Finance Companies by Internal Finance Wing of the Ministry of Finance and Economic Affairs. HFCs are regulated by the State Bank of Pakistan.

Following discussions in early 1994, it was agreed that the licensing mechanism for HFCs would eventually be transferred from the Ministry of Finance to the State Bank of Pakistan. However, at the time of this document's publication, licensing remains the responsibility of the Ministry of Finance.

The first part of the handbook describes the emerging role of the private sector in housing finance and provides a broad overview of Pakistan's housing sector and the issues and opportunities for HFCs. In effect, it is a brief primer on housing finance.

The second part of the handbook provides a guide to the licensing process, with a detailed description of information needed, requirements to be met, and the legal framework in which HFCs operate. Included are the Statutory Regulation Orders governing the establishment of HFCs and the State Bank's Prudential Regulations for Non-Banking Financial Institutions, under which the operations of HFCs are regulated.

Part I: Background

The Housing Sector Lacks Resources

In Pakistan, resources for housing have long been in short supply. The inadequacy of long-term funds for construction, purchase, and improvement, plus the virtual non-availability of construction bridge finance, have greatly constrained the growth of housing stock. In effect, people are unable to obtain the housing they can afford—often because they can not obtain housing finance.

Although the public sector has developed many housing schemes, developed hundreds of thousands of serviced plots, and has operated the House Building Finance Corporation (HBFC) to provide mortgage loans, the total resources available from the public sector for housing has remained far less than demand, amounting to perhaps one-fifth of total demand.

Many of the serviced plots remain undeveloped, while existing housing is becoming increasingly crowded; the total housing backlog now exceeds six million units. Against an annual need for more than 500,000 new units, the public sector has resources to develop perhaps 100,000 plots. Resources for HBFC have been far more limited, and Government has decided to put HBFC on a commercial basis.

A Market-Oriented Housing Finance Strategy

In 1989, with the assistance of the United States Agency for International Development (USAID), the Ministry of Finance began to examine the issues facing the development of market-oriented housing finance in Pakistan and initiated a strategy to promote the establishment of HFCs. This strategy included developing a legal framework for private HFCs, a licensing process, and incorporated HFCs into the network of emerging new non-banking financial institutions that are now regulated by the State Bank of Pakistan.

In December, 1992, the strategy met with its first success: the opening of Citibank HFC in Lahore; in October, 1993, a second HFC, International Housing Finance Limited, opened in Karachi. Several other firms are well on the way to completing plans for opening HFCs, and the Ministry remains committed to seeing that additional firms come into being so that housing finance develops into a healthy, competitive industry that is able to meet the housing needs of Pakistan.

The Housing Market

The potential opportunities in the housing sector are vast in scope, as suggested by several indicators:

- The housing "backlog" is estimated at 6.5 million units.
- Present annual investment in housing is estimated at Rs. 18 billion.
- Investment is growing at an estimated 15% per year (current rupees).
- Annual demand is estimated at 500,000 units.

Virtually none of the financing of this massive investment presently flows through formal sector financing institutions. In a study conducted for the USAID Shelter Resource Mobilization Program (SRMP), one-third of the respondents indicated a desire to use formal sector housing loans to finance their housing investments. It can be expected that as HFCs become known, demand for formal sector housing loans will grow rapidly, especially in urban areas, where latent demand is high.

What Do HFCs Finance?

HFCs provide a broad range of housing loans based on consumer preferences: for families to purchase houses or flats, to construct new houses, to finance alterations, improvements, and additions to existing housing. HFCs can also provide a portion of the finance for purchasing land in connection with construction of a home. HFCs can offer construction finance in collaboration with housing developers at the project development stage as well as "take-out" mortgage loans to enable families to purchase the units constructed.

Resource Mobilization by HFCs

In addition to raising share capital, HFCs are permitted to mobilize resources through approved deposit schemes of not less than 30 days maturity, to issue short and long term foreign debentures, and by issuing redeemable securities such as modarabas, commercial paper, and term finance certificates. HFCs can float and manage modarabas, arrange lines of credit in the call money market, and raise funds through rediscounting facilities and advancing loans by way of markup to other HFCs.

Since it is recognized that HFCs are new entities in the finance sector and may face difficulties attracting deposits initially, the Ministry of Finance plans to work with USAID and the State Bank to establish a housing loan refinance window at State Bank. This window will enable HFCs to re-capitalize and will operate on a market basis. To obtain refinance, HFCs will need to ensure that the loans they make meet eligibility criteria related to the underwriting soundness of the loans. The development of the refinance window is a first step toward eventual development of a secondary market in housing finance and could lead to development of tradeable mortgage-backed securities and other securities that would facilitate the flow of finance within the housing sector.

The Environment for Housing Finance

Developing a "well-functioning" housing finance system is recognized to be a complex task. While success depends a great deal on the quality of entrepreneurship demonstrated by HFC managers, HFCs operate in an environment influenced by many factors: economic policy and general economic performance, fiscal and monetary policy and the level of development of the finance sector, urban and housing policy and capabilities, the functioning of land markets, the capacity of the construction industry, the adequacy of debt recovery laws and procedures, the adequacy of land titling and transfer systems, and the adequacy with which development is regulated. Many of these are issues facing housing finance in Pakistan.

Within the region, there are many examples of housing finance systems at different stages of development, each with different prospects for growth. Housing finance has been started in Sri Lanka, India, Malaysia, Thailand, Nepal, Indonesia, Korea, Bangladesh, and the Philippines. Some systems, like those in Thailand, Korea, and Malaysia, are well established and are important contributors to economic growth and financial sector development. Others, like those in Sri Lanka, India, and the Philippines, are less well-established but growing and innovating. The success of each system reflects the policies, laws, and capacities of each country.

In Thailand, for example, Bangkok has experienced a boom in housing construction. While its expanding economy has supported this boom, three key ingredients stimulated the housing sector: the commercial success and leadership of Government Housing Bank, which prompted private lenders into housing finance; the extensive de-regulation of urban development; and institution of a simple and speedy land titling and transfer process. The result: in terms of choice of housing unit and cost per square foot in comparison to income, Bangkok's housing sector provides families with the most housing for their money in Asia.

In Malaysia, where urban development, housing developers, and finance are more tightly regulated than in Thailand, housing finance is becoming well-developed with capable lenders in both the private and public sectors. The housing sector is expanding vigorously, encouraged by implementation of an effective land titling system and strong legal sector support for debt recovery, but housing supply and unit choice is more limited and cost in comparison to income is higher than Thailand. In Korea, the finance sector has long been tightly regulated and credit directed, with housing finance largely in the public sector. Although the public sector Korean Housing Bank is commercially successful, housing and urban development has proceeded more slowly, and housing costs are quite high relative to income.

India offers an example pertinent to the development of housing finance in Pakistan. Cumbersome and expensive land titling and transfer procedures, inadequate foreclosure processes, inefficient land markets, unplanned growth, and an over-regulated urban development sector all constrain the growth of housing finance. Yet, housing finance in the private sector has boomed over the past 10 years. Much of the credit for this is due to high levels of skilled entrepreneurship shown by private sector leaders, such as the founders of Housing Development Finance Corporation, which has become a large, respected, and profitable finance institution that has prompted many other companies, including major public sector insurers, to enter the field.

Issues Facing Housing Finance in Pakistan

Many issues face the development of housing finance in Pakistan. Although the need for vastly-expanded housing finance facilities is widely recognized by public policymakers, many aspects of policy remain inimical to housing finance. These issues are often complex and intertwined. Resolution of them will be difficult and will require that the public sector strive to create an environment that enables housing finance to thrive, while the private sector displays initiative to mobilize resources and explore lending to various segments of the market. For many years, housing and housing finance have been viewed, in terms of public policy, as purely a "social" sector requiring subsidies. A basic reform in policy outlook is required, one that recognizes that housing can be a powerful "engine" of the economy and that the housing sector needs to be managed in a way that maximizes its contribution to the economy and to development of the finance sector.

Land and Foreclosure

In a very fundamental way, land issues are at the heart of developing a successful housing finance system that can meet the needs of the great majority of Pakistanis. Property is the collateral offered for housing loans in almost all countries. Yet, in Pakistan, the land titling, registration, and transfer process is flawed and expensive. Most title documents are suspect and easily challenged, under-cutting the value of land as security for a loan. Transfer costs are high and many land transfers are virtually informal to avoid paying stamp duties. It is essential that as a matter of public policy, Pakistan develop an adequate and inexpensive land registration system.

In the event of default, the legal process works very slowly to foreclose on pledged property. Housing lenders need to recognize that land title and foreclosure are significant, but not insurmountable problems. As has occurred in India, housing lenders can avoid many land-related problems by careful loan underwriting and efficient administration, so that their focus is on making "good" loans and ensuring that their loan repayment procedures are efficiently administered. As a priority of public policy, Pakistan needs to take steps that ensure that the legal system, while recognizing the legitimate rights of borrowers, operates far more efficiently to protect the legitimate interests of lenders.

Resource Mobilization

A second fundamental issue is resource mobilization. Housing finance companies are new and will face many difficulties raising funds from the capital markets. In effect, new housing finance companies will, at least in their initial stages, find that most of the capital they can raise will be at relatively high market rates, forcing them to lend at high rates. Clearly, this limits the size of the market. Housing finance companies need to develop new capital market instruments, such as bonds. However, they also need to recognize that innovative instruments will be successful only to the extent that the companies offering the bonds have developed solid reputations as financial institutions.

Housing finance companies also need to experiment vigorously with deposit-taking mechanisms and develop techniques, such as loan-linked contract savings schemes, that provide new incentives for households to save. Deposits are a prime source of relatively low-cost capital. However, although housing finance companies are envisaged as "savings institutions," the environment for savings mobilization is marred by bitter experience on the part of many households with unregulated and frequently unscrupulous "finance companies" and "housing societies" that have engaged in fraud. To overcome this, housing finance companies need to ensure that their management is sound and that their public image is attractive to savers. At the same time, the public sector must play a strong role to ensure that housing finance companies can succeed in attracting savings, by encouraging innovative savings mechanisms and by ensuring that housing finance companies are adequately regulated by the State Bank.

The public sector can also play a direct role in resource mobilization. The Government is committed to establishing a housing loan refinance window at the State Bank of Pakistan. This window will provide a source of discounted market-rate funding to enable companies to re-capitalize. As companies make loans, the loans will be "packaged" and purchased by the State Bank. However, although the Government can facilitate the growth of housing finance by mobilizing resources to devote to the window, it is not foreseen that the window will become a major source of capital. Rather, it is seen as a short-term mechanism to enable housing finance companies to gain access to capital during the period in which they are becoming sufficiently established to build reputations that enable them to go directly to the capital markets.

Another role for the public sector lies in eventual development of a secondary market related to housing lending. A secondary market enhances resource mobilization by making assets such as mortgages, which are linked to real property, into liquid financial assets that can be traded and leveraged. One avenue for development of a secondary market is to focus on development of a mortgage-backed security, essentially a financial instrument that is backed by the cash flow from housing loans.

To reach the point where investors could have confidence in such an instrument, it is critical that a reputable system be put in place which tracks the performance of housing loan repayments. It is proposed that "packages" of mortgages that are refinanced by the State Bank be subject to such monitoring, and that State Bank require housing lenders to regularly report on the actual repayment performance of all loans within the "package." Over several years, a "track record" of repayment will be established and can form the basis by which investors can measure the risk associated with housing lending. It is also critical that housing finance companies have adequate management information systems and work together to develop and use standardized loan documents and underwriting standards.

Urban Development

Pakistan is urbanizing at a rapid rate and should no longer be viewed as a rural, agricultural society. By many estimates, a majority of Pakistanis will live in urban areas by the year 2000; other estimates claim that a majority already does live in urbanized conditions, even if not within recognized urban boundaries. Yet, most of this development has occurred with little planning and little control. In effect, there has been an explosion of housing over the past 10 to 20 years. Most of this has been in informal unplanned settlements, partly because the land development system has performed inadequately, and partly because people have had few opportunities to obtain housing credit necessary to purchase planned units. The consequences of unplanned urbanization are intimately linked with inadequacy and deterioration of urban infrastructure. As a matter of public policy, Pakistan needs to achieve far better performance from its urban sector. Housing finance can be a major contributor to this, by mobilizing the resources needed for construction and mortgage financing for development of orderly mass housing development.

Middle and Lower-Income Lending

Clearly, a major reason for the public sector to encourage the development of housing finance is to establish a market-oriented system for meeting the housing credit needs of the great majority of the population. At present, the new housing finance companies experience difficulty reaching below the upper income levels of society. However, even as housing finance companies become well-established, they will always encounter difficulties lending to households at lower to middle income levels. In part this is because at present, the structure of mark-up rates is high, and the cost of funds to housing finance companies is high. In part, it is also because the administrative costs of originating a loan are very similar regardless of the size of the loan, and it is inherently less profitable to make many small loans than to make fewer large loans. It is probable that until and unless housing finance companies can address lower-income housing credit needs, many policy-makers will be reluctant to embrace market-oriented housing finance.

Yet, it is the middle and lower-income households—precisely the ones with the greatest need for housing credit—that have the least access to land with clear title, plots with adequate services, and regular steady incomes, and the least ability to afford the high costs of land transfers and mortgage origination costs. In summary, it is these households that are the most disadvantaged by poor performance of the urban sector. As housing finance develops, Pakistan needs, as a matter of public policy, to take steps to improve urban performance so that the benefits of housing and housing finance can flow to all segments of society.

The first step necessary is to view the housing sector as an economic sector that needs to perform well economically in order that the social benefits of adequate housing can flow to all income levels. The second step is to ensure that a housing sector policy environment is developed that encourages the growth of a vibrant, strong, market-based housing finance system capable of meeting people's needs.

Part II: The Legal Framework

The Companies Ordinance of 1984 establishes standards of accountability by defining the duties, obligations, and responsibilities of Directors, Chief Executives, Secretaries, Accountants, and other Officers of licensed companies; the rights of shareholders; and the penalties for failure to comply with the Ordinance.

Once permission to establish a housing finance company is obtained from the Ministry of Finance, registration as a company under the Companies Ordinance of 1984 must be secured before applying to the Ministry of Finance for a license to operate an HFC.

Thus, the licensing process can roughly be broken down into three steps:

1. Permission to practice housing finance under S.R.O. 137.
2. Incorporation as a company under the Companies Ordinance of 1984.
3. Licensing as an HFC under S.R.O. 137.

The procedure for incorporation as a company under the Ordinance of 1984 is not within the scope of this brochure, which is designed primarily to provide information about the permission and licensing process of HFCs.

Further information regarding filing requirements under the Companies Ordinance can be obtained from the Corporate Law Authority (CLA). A companion handbook to the Ordinance—*Filing Requirements under the Companies Ordinance, 1984 and the Companies (General Provisions and Forms) Rules, 1985*—has been prepared by the Institute of Chartered Secretaries and Administrators, Pakistan Association, and contains a comprehensive list of requirements and forms required under the Ordinance.

Because an integral component of housing finance is to mobilize resources for housing investment, it is only prudent that channels of investment be secure and regulated. The statutory regulations promulgated in this regard seek not only the protection of the interests of investors and consumers, but also the ongoing development of a healthy housing finance sector.

Statutory Regulation Order (S.R.O.) 1356 establishes the legal framework for housing finance company operations: definitions; commencement of operations; share capital; qualifications of personnel; terms and conditions of operation; restrictions on purchase or sale by beneficial owners; monitoring and regulation; functions; rate of mark up and fees; insurance coverage; prohibition of certain transactions; and penalties for noncompliance.

For easy reference, S.R.O. 295 and S.R.O. 547, which are amendments to S.R.O. 1356, have been incorporated into the text of the document and are indicated by parenthetical *"Notes"*. These amendments are also reprinted in their entirety following the S.R.O.

Prior to taking any formal action in pursuit of authorization or licensing, housing finance professionals should study and carefully evaluate the conditions set forth in this regulation.

S.R.O. 137, dated the 18th of February, 1991 and published in the Official Gazette of Pakistan on February 25, 1991, outlines the procedure to (1) request permission to establish a housing finance company, and (2) after permission is obtained, the procedure to apply for licensing.

Applicants are advised to read and follow all of the instructions in Annex-I, the Form I Application, and the Annex to the Form I Application very carefully. This information is critical to the evaluation and licensing process.

S.R.O. 548, an amendment, is incorporated via a parenthetical *"Note"*, and also appears in its entirety following the S.R.O.

S.R.O. 1356

S.R.O. 1356 (I)/90.—In exercise of the powers conferred by sub-sections (4) and (4A) of section 3 of the Capital Issues (Continuance of Control) Act, 1947 (XXIX of 1947), the Federal Government is pleased to direct that all consents and permissions in respect of a company engaged in the business of housing finance for issue of capital, for making public offer or taking any other action under sub-section (2) or sub-section (3) of the said section shall be subject to the following conditions, namely:—

1. **Definitions.**—In this notification, unless there is anything repugnant in the subject or context,—
   - (a) "company" means a company incorporated under a law for the time being in force;
   - (b) "business of housing finance" means a business described under clause 8;
   - (c) "housing finance company" means a company licenced to do business under this Notification;
   - (d) "borrower" includes any customer of a company under any of the forms of non-interest based modes of financing prescribed by the State Bank of Pakistan from time to time and shall also include a hirer or lessee where financing is by way of hire purchase or leasing.
2. **Commencement of operation.—**
   - (a) A housing finance company (HFC) shall commence business and operations only after it has been registered and issued a licence under this notification by the Federal Government.
   - (b) An HFC proposing to commence its business of housing finance shall make an application to the Federal Government, in the manner notified by the Federal Government in the official Gazette, with a declaration that it complies with all the terms, conditions and requirements of this notification and shall comply with all that is required of a housing finance company in the conduct of such business.
3. **Share capital.—** A housing finance company shall not be permitted to issue capital (*Note: Underlined text has been amended to "granted licence", see S.R.O. 295 below*) unless it:—
   - (a) is incorporated as a public limited company under the law for the time being in force;
   - (b) has a minimum paid up capital of one hundred (*Note: Underlined text deleted and "fifty" substituted per S.R.O. 547, see below.)* million rupees and has been listed on the Stock Exchanges of Pakistan; (*Note: Underlined text has been deleted, see S.R.O. 295 below)* and

(c) has clearly and concisely stated its financing and investment policy in its memorandum and articles of association.

(Note: The following new paragraph (underlined) shall be inserted, see S.R.O. 295 below).

3A. <u>**"Companies to be listed on the Stock Exchanges.**—Every housing finance company after obtaining licence to carry on business shall get itself listed on the stock exchanges of Pakistan within a period of two years from the date of issue of such licence;"</u>

(Note: The following underlined clause shall be inserted at the end of paragraph 3A per S.R.O. 547, see below.)

<u>"and shall raise further capital of at least fifty million rupees and shall submit a copy of the draft prospectus to the licensing authority."</u>

4. **Qualifications of directors, etc.**—No persons shall be elected or appointed as a director, an officer or an employee of a housing finance company who—

   (a) has been convicted of an offence involving fraud, breach of trust or moral turpitude; or

   (b) has been adjudged as insolvent, or has suspended payment of his debts or has compounded with his creditors.

5. **Terms and conditions of operation.**—A housing finance company shall operate under the following conditions namely;

   (a) the company shall extend loans on commercial terms to the following extent of the total cost

      (i) in the case of residential property: 80%

      (ii) in the case of non-residential property: 60%

      (iii) for additions, alterations or improvements in existing property: 60%

   (b) the ratio of equity to liabilities for the first two years shall be one to seven; thereafter, it shall not be more than one to ten; <u>and</u> *(Note: underlined word added per S.R.O. 295, see below.)*

   (c) foreign participation shall require specific approval of the Federal Government; <u>and</u>

   (d) <u>no finance will be provided for purchase of land.</u> *(Note: Underlined text deleted and a full stop added following* "Government" *per S.R.O. 295, see below.)*

6. **Bar on purchase or sale by beneficial owners.**—A housing finance company shall not, without the prior approval in writing of the Federal Government, purchase anything from, or sell anything to any director, officer, employee of the company or from or to a person who either individually or in concert with close relatives beneficially owns ten per cent or more either of the equity or other securities with voting rights, if any, issued by such housing finance company.

7. **Monitoring and regulation.**—For purposes of monitoring and regulation, a housing finance company shall be treated as non-banking financial institution and be subject to same monitoring and regulation arrangements as may be prescribed by the Government for other non-banking financial institution.

8. **Functions of housing finance company.**—The following shall be the functions of the housing finance companies, namely:—

(a) mobilisation of long term savings exclusively for housing investment;

(b) to provide long term finance for the purpose of constructing, purchasing or making any additions, alterations or improvement to or in any property;

(Note: The following new clause (underlined) shall be inserted, per S.R.O. 295, see below.)

(bb) "to provide long term finance for the purpose of purchasing of land in connection with the purposes listed in clause (b), provided that the loan for the purpose shall be limited to 50% of the total loan sanctioned within the debt equity ratio prescribed by the State Bank of Pakistan, from time to time, or 50% of the value of land, whichever is less; and"

(c) leasing and renting on hire purchase of buildings for residential and commercial purposes;

(d) establishing and managing housing schemes; *(Note: Underlined clause omitted and the following underlined clause substituted, per S.R.O. 295, see below.)*

(d) "establishing and managing housing schemes without engaging in real estate business or working as subsidiary or holding companies of construction business;"

(e) carrying out surveys and valuations of land and properties;

(f) arranging for the provisions of insurance of pledged property;

(g) managing mortgage investments as agents;

(h) management of projects, public or private sector, in the housing and urban development sectors;

(i) making loans and advances for house building to individuals, projects and housing companies;

(j) Raising their funds, in addition to share capital from:—

  (i) commercial paper, term finance certificates and deposits of not less than thirty days maturity duly approved by the Government;

  (ii) floating and managing Modarabas;

  (iii) foreign debentures both short and long term;

  (iv) issuance of redeemable capital (Participation Term Certificates or Term Finance Certificates, etc.);

  (v) lines of credit;

  (vi) re-discount facilities; and

  (vii) advancing loans on mark up to other housing finance companies.

9. **Rate of mark up and fees.**—A housing finance company will charge mark up rate on its loans in accordance with the prevailing rates, provided that, where disbursement is held up by the company for any reasons, the commitment fee charged shall not exceed one per cent of the un-disbursed balance.

10. **Insurance coverage.**—A housing finance company shall

(a) obtain sufficient insurance coverage on its own or on its clients' benefit against any losses that may be incurred as a result of employees' fraud or gross negligence; and

(b) ensure that properties being financed by it are covered by adequate fire and casualty insurance.

11. **Bar to certain transactions.**— No housing finance company shall—

(a) grant a loan to any employee, officer director or a shareholder having a beneficial ownership including that of close relatives of more than 10% in the paid up capital of the housing finance company whether directly or indirectly (through their close relatives, companies controlled by them, affiliates, subsidiaries, or by way of acting in concert with others);

(b) transfer ownership of controlling shares, merge with, acquire or take over any other housing finance company unless it has obtained the prior approval of the Federal Government in writing to the scheme of such merger, acquisition or take over; or

(c) employ as a broker, directly or indirectly, any of its directors, officers, or employees, or a person who beneficially owns whether individually or in association with close relatives ten per cent or more either of the equity or other securities with voting rights, if any, issued by the housing finance company.

12. **Penalties.—**

(a) Without prejudice to an action and punishment under section 13 of the Act, in case of contravention of any provision of this notification the Federal Government may cancel the registration or licence of the housing finance company after issuing a show cause notice and giving such company an opportunity of being heard or pass another order deemed appropriate by the Federal Government.

(b) Upon cancellation of the registration or licence, the functions and carrying on the business of housing finance company shall cease and the Federal Government may move the Court for a winding up order in respect of the company.

S.R.O. 295

Islamabad, the 25th April, 1992

S.R.O. 295 (I)/92.—In exercise of the powers conferred by sub-sections (4) and (4A) of section 3 of the Capital Issues (Continuance of Control) Act, 1947 (XXIX of 1947), the Federal Government is pleased to direct that the following amendments shall be made in its Notification No. S.R.O. 1356 (I)/90, dated the 24th December, 1990, namely:—

In the aforesaid Notification,—

(a) In paragraph 3,—

(i) for the words "permitted to issue capital" the words "granted licence" shall be substituted; and

(ii) in clause (b), the words "and has been listed on the Stock Exchanges of Pakistan" shall be omitted;

(b) after paragraph 3, amended as aforesaid, the following new paragraph shall be inserted, namely:—

"3A. **Companies to be listed on the Stock Exchanges.—**

Every housing finance company after obtaining licence to carry on business shall get itself listed on the stock exchanges of Pakistan within a period of two years from the date of issue of such licence";

(c) In paragraph 5,—

(i) in clause (b), after the semi-colon at the end, the word "and" shall be added;

(ii) in clause (c), for the semi-colon and the word "and" the full stop shall be substituted; and

(iii) clause (d) shall be omitted; and

(d) In paragraph 8,—

(i) after clause (b), the following new clause shall be inserted, namely:—

"(bb) to provide long term finance for the purpose of purchasing of land in connection with the purposes listed in clause (b), provided that the loan for the purpose shall be limited to 50% of the total loan sanctioned within the debt equity ratio prescribed by the State Bank of Pakistan, from time to time, or 50% of the value of land, whichever is less;" and

(ii) for clause (d) the following shall be substituted, namely:—

"(d) establishing and managing housing schemes without engaging in real estate business or working as subsidiary or holding companies of construction business;".

S.R.O. 547

Islamabad, the 27th June, 1993

S.R.O. 547 (I)/93.—In exercise of the powers conferred by sub-sections (4) and (4A) of section 3 of the Capital Issues (Continuance of Control) Act, 1947 (XXIX of 1947), the Federal Government is pleased to direct that the following amendments shall be made in its Notification No. S.R.O. 1356 (I)|90, dated the 24th December, 1990, namely:—

In the aforesaid Notification,—

(a) in paragraph 3, in clause (b), for the words "one hundred" the word "fifty" shall be substituted; and

(b) in paragraph 3A, after the word "licence" at the end, the semi-colon and words "; and shall raise further capital of at least fifty million rupees and shall submit a copy of the draft prospectus to the licensing authority" shall be added.

S.R.O. 137

S.R.O. 137 (I)/91.—Pursuant to sub-paragraph (b) of paragraph 2 of Finance Division's S.R.O. 1356 (I)/90, dated the 24th December, 1990, the following procedure for applying to the Joint Secretary (IF), Finance Division, Government of Pakistan for registration as Housing Finance Company is notified for public information:—

(i) In the first instance, those desirous of registration as Housing Finance Company should apply to the Joint Secretary (IF), providing information (as given at Annex-I) for obtaining permission to form a Housing Finance Company.

(ii) On receipt of the permission from the Federal Government, the sponsors should apply to Joint Secretary (IF) on form-I.

(iii) The specimen of license to be issued by JS (IF) permitting the companies to carry on the business of Housing Finance Company is also published for public information (Form-II).

ANNEX -1: INFORMATION TO BE SUPPLIED FOR OBTAINING PERMISSION TO FORM A HOUSING FINANCE COMPANY IN TERMS OF S.R.O. 1356 (I)/90, DATED 24TH DECEMBER 1990.

1. Full names, any former names, Father's/Husband name, nationality, full residential and business addresses and details of other directorships and occupations of the proposed directors and officers including, Chief Executive and Chairman of the Board indicating their respective designation and name of firms in which any one is a partner.
2. Name of Companies, firms or organizations of which the aforesaid directors and officers have been directors, managers, officers, employees or partners in the past.
3. Financial standing, professional qualifications and experience of persons mentioned in (1) above supported by documentary evidence.
4. Whether any aforesaid person has ever been convicted of fraud or breach of trust or of an offence involving moral turpitude or removed from service. If so, full particulars thereof.
5. Whether any person referred to in (1) above or any company or firm in which he has been associated in the past has been adjudicated an insolvent or has suspended payment or defaulted in making payments or has compounded with his or their creditors or gone into liquidation: If so; full particulars thereof.
6. Shareholdings of the person referred to in (1) above in the proposed company
7. Names of professionals to be engaged for management.
8. Description of business operations to be undertaken and organisational set up and plans along with feasibility report if prepared.
9. Bank References

FORM I: APPLICATION FORM FOR REGISTRATION OF HOUSING FINANCE COMPANY

(See paragraph 2 (b),S.R.O. 1356/90 dated 24th December 1990)

Date:
The Joint Secretary (IF)
Finance Division
Government of Pakistan
Islamabad

Dear Sir,

1. We hereby apply for registration under paragraph 2 of S.R.O. 1356 (I)/90 dated 24th December, 1990, as an Housing Finance Company.
2. We hereby confirm—
   (a) that it is registered under the Companies Ordinance of 1984 as a public limited company with paid up capital of Rs. one hundred million *(Note: Underlined text deleted and "fifty" substituted per S.R.O. 547. see below)*; of which sponsors portion of proposed equity has already been deposited in the bank account of the company.
   (b) that none of its directors, officers or employees, has been convicted of fraud or breach of trust or of an offence involving moral turpitude.
   (c) that none of its directors, officers or employees, has been adjudged an insolvent or has suspended payment or has compounded with his creditors:
   (d) that it has engaged adequate qualified staff, the details of which are as follows;—
3. Three copies of the following documents pertaining to the company are also enclosed;—
   (a) Memorandum and Articles of Association duly certified and signed by all directors.
   (b) Certificate of incorporation (one copy of which is certified by the Registrar, Joint Stock Companies).
   (c) Draft prospects for public offer of securities. *(Note: Underlined omitted per S.R.O. 548, see below.)*
   (d) Latest audited Balance sheet and Loss Account together with related documents; if any.
4. Information and documents as required in the Annexure to this form duly verified and signed by all directors along with three spare copies of this application and an affidavit as to the correctness of the details by the Chief Executive and two directors are furnished herewith. We undertake to keep this information up to date by communicating changes, modifications therein within fourteen days of such changes/modifications.
5. We further undertake that no change in the Memorandum and Articles of Association nor any change in the majority shareholders and directors shall be made without prior written authorisation of the Joint Secretary (IF) and that we shall comply with all requirements of law and conditions of registration.
6. We being authorised by the directors of the company hereby solemnly declare and affirm that to the best of our knowledge and belief the information contained in this application (Form-I), annex to Form-I and the documents accompanying thereto are true and correct and that all terms, conditions and requirements of S.R.O. No. 1356 (I)/90 of 24th December, 1990, in respect of all matters precedent to the registration of the said as an Housing Finance Company or incidental thereto have been duly complied with and the said company shall also comply with all that is required of an Housing Finance Company in the conduct of such business.

Yours faithfully,   Verified by Oath Commissioner,

ANNEX TO FORM I

1. Name of the Company.
2. Registered office of the company.
3. Date of incorporation as a public limited company.
4. Authorised, subscribed and paid up capital of the company.
5. Management
   - (a) Names, business, and addresses of directors, amount of shares held by each and name(s) of the banker(s) of each of them.
   - (b) Director's interest, direct or indirect, in any other company(ies) giving details of such interest.
   - (c) Details of persons or group controlling the company including of those persons who own 10% or more shares given number and value of shares held.
   - (d) Name(s) of holding, subsidiary and associated undertaking(s), if any.
   - (e) Whether any director, officer or employee of the company has been convicted of any fraud or breach of trust or committed any offence involving moral turpitude or has been adjudicated as insolvent on suspended payment or compounded with his creditors.
   - (f) Name of the proposed Chief Executive Officer of the company, his qualifications, experience, and proposed remuneration.
6. Reasons for selecting the proposed place of business giving statistical data, if any.
7. Whether the company fulfills all the conditions laid down in S.R.O. 1356 (I)/90 and whether it is agreeable to permit J.S. (IF) or any officer authorised on his behalf to satisfy himself by inspection of the books of the company or other-wise that the prescribed conditions are being fulfilled by the company.
8. Any additional facts which the company may wish to add in support of its application.

To be completed by the Internal Finance Wing:

1. Date of receipt of application..
2. Date of Registration ....
3. Registration No...
4. Date of Issue of Licence..

Signature of Joint Secretary (IF),

____

FORM II [See Paragraph 2 (b)]

SPECIMEN: LICENCE TO CARRY ON THE BUSINESS OF AN HOUSING FINANCE COMPANY

OFFICE OF THE JOINT SECRETARY (INTERNAL FINANCE)

Islamabad, the .... 19..........

Registration No..

Certified that having considered the application for registration under S.R.O. 1356 (I)/90 and being satisfied that the Company, whose particulars are specified below, is being eligible for registration. I, in exercise of the powers conferred under paragraph 2 (b) of S.R.O. 1356 (I)/90 do hereby grant licence to the company subject to the conditions laid down in the said S.R.O. or imposed thereafter.

1. Name...
2. Address.................................:...
3. Date of Registration...
4. Other particulars, if any...

Issued under my signature and seal,

____

Signature of the Joint Secretary (IF)

S.R.O. 548

Islamabad, the 27th June, 1993

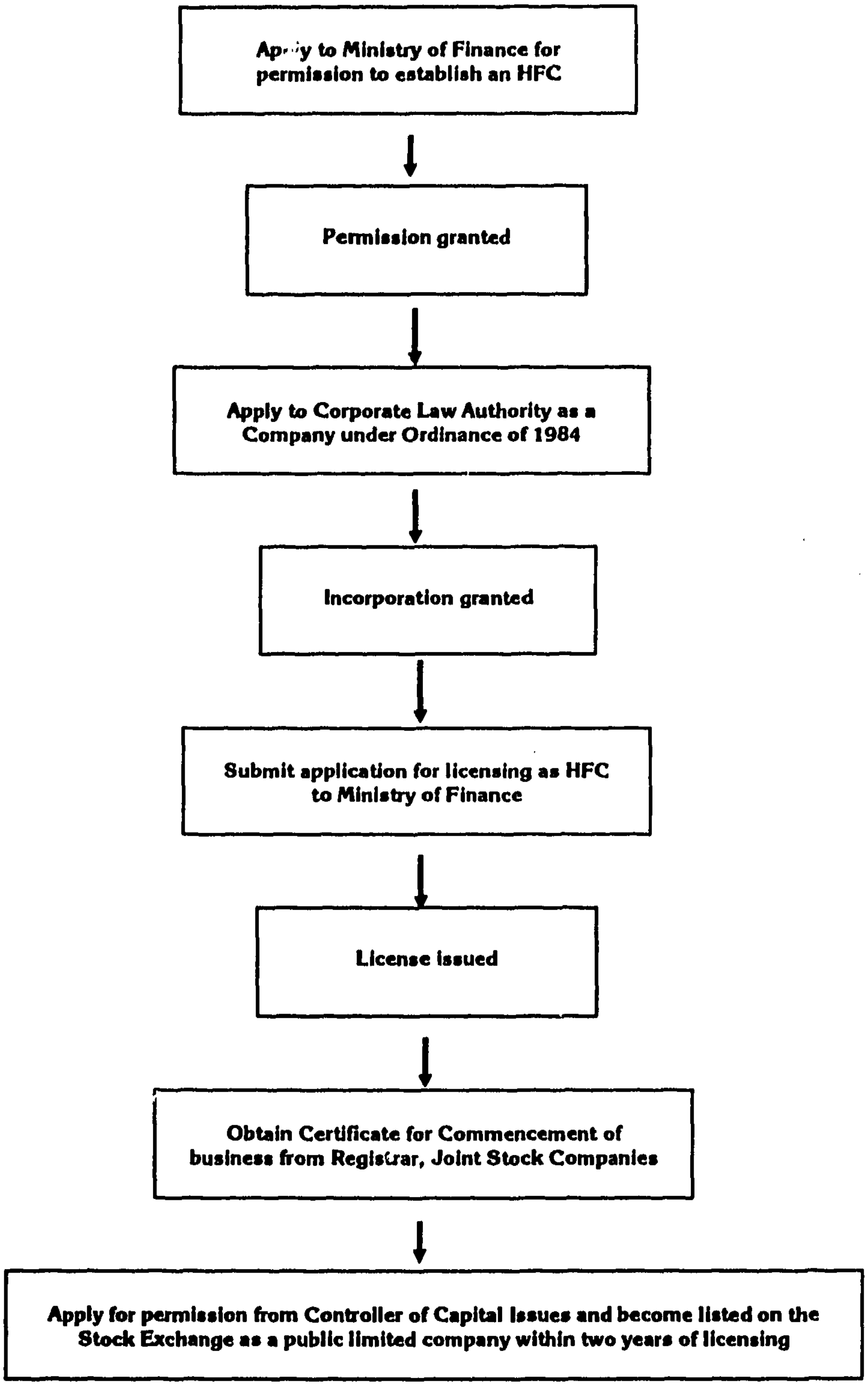
S.R.O. 548 (I)/93.—In pursuance of clause (b) of paragraph 2 of Finance Division's Notification No. S.R.O. 1356 (I)/90, dated the 24th December, 1990, the Federal Government is pleased to direct that the following amendment shall be made in its Notification No. S.R.O. 137 (I)/90, dated the 18th February, 1991, namely:—

In the aforesaid Notification dated the 18th February, 1991, in Form I, in Paragraph 3, clause (c) shall be omitted.

After a license is granted by the Ministry of Finance, an HFC must obtain a certificate for commencement of business from the Registrar, Joint Stock Companies, Corporate Law Authority (CLA). As indicated in S.R.O. 137, an HFC must become listed on the Stock Exchange as a public limited company within two years of licensing.

When applying for initial permission from the Ministry of Finance to practice housing finance, it is extremely important to the evaluation process for applicants to provide ALL of the required information and documentation as indicated in Annex 1 of S.R.O. 137. Likewise, once permission is granted, applicants must be careful to ensure that all subsequent information required by Form I and Annex to Form I are provided in the application for licensing. A flowchart of the Housing Finance licensing process appears on the following page.

Establishing a Housing Finance Company



Rules of Business for NBFIs

Through an amendment in the Banking Companies Ordinance of 1962, the Government has assigned the responsibility of supervising the business of NBFIs, including Housing Finance Companies, to the State Bank of Pakistan. Accordingly, the State Bank has framed Rules of Business for NBFIs, which became effective January 1, 1992, and are reprinted below.

A. Definitions

For the purposes of these regulations:

a) "NBFI" means a Non-Bank Financial Institution and includes a DFI, Modaraba, Leasing Company, Housing Finance Company, and Investment Bank.

b) "Exposure" would include fund and non-fund based facilities.

c) "Principal Lines of Business" would mean:

  i) For a leasing company, the leasing business.

  ii) For a Development Finance Institution, fixed investment financing and other lines of businesses declared by the DFI in order of priority.

  iii) For an Investment Bank, lines of businesses declared by the Investment Bank in order of priority.

  iv) For Housing Finance Companies, the financing of housing.

  v) For a Modaraba lines of business declared by the Modaraba in order of priority or as specified by Registrar Modaraba.

d) "Facilities to Small Entrepreneurs" would mean:

  i) Facilities allowed by the NBFI for genuine business purpose up to Rs. 300,000.

  ii) Facilities allowed to Industrial Units, including cottage industries, which have fixed assets (excluding land and buildings) the original value of which does not exceed Rs. 20,000,000.

e) "Major Shareholder" would mean any person holding 5% or more of the share capital.

f) "Person" includes an individual, a Hindu undivided family, a firm, an association or body of individuals whether incorporated or not, a company and every other juridical person.

g) "Records" include ledgers, day books, cash books and all other manuals or magnetic records used in the business of the NBFI.

h) "Documents" include vouchers, bills, promissory notes, securities for leases/advances and claims by or against the company and other documents supporting entries in the books of the NBFI.

i) "Equity" includes Share Capital and Reserves.

j) "Facilities" would include fund based and non-fund based facilities.

k) "Lease Key Money" means lease security deposit.

B. Rules

Limits on Exposure

1) Liabilities, excluding contingent liabilities, of a NBFI for the first two years of its operations shall not exceed seven times of its equity. In the subsequent years the liabilities shall not exceed ten times of the equity of the NBFI.

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

Creation and Building Up of Reserve

3) Every NBFI 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.

b) Thereafter a sum not less than 5% of its after tax profits. Stock dividends shall be treated as appropriation for the purpose.

Deposit Insurance

4) When Deposit Insurance arrangements are in place, every NBFI shall arrange full insurance cover for its deposits/COIs etc. up to Rs. 100,000/-

Return on Deposits

5) Every NBFI shall allow a rate of return to all its depositors/COI holders on uniform basis i.e. rate of return shall be the same for the same maturity period irrespective of amount, deposits etc. of Listed Companies, recognized charitable trusts and statutory bodies shall be exempt.

Maintenance of Liquidity Against Certain Liabilities

6) Not less than 15% of the NBFIs liabilities shall be invested in Government Securities. For this purpose liabilities shall not include NBFI's equity and its borrowing from Financial Institutions and Lease Key Money. In the case of Modarabas if the Religious Board does not permit investment in Government Securities e.g. Federal Investment Bonds (FIBs) they will comply with this regulation by investing in NIT Units.

Obtaining of Audited Accounts from Borrowers

7) Every NBFI shall regularly obtain accounts from every borrower in the following manner and keep the same on its record:
   a) Exposure not exceeding Rs. two million. Accounts to be signed by the borrower.
   b) Exposure exceeding Rs. two million but not exceeding Rs. 10 million. Accounts to be signed by the borrower and countersigned by the Internal Audit Officer of the NBFI or a practicing Chartered Accountant.
   c) Exposure exceeding Rs. 10 million. Accounts to be audited and signed by a practicing Chartered Accountant.

Maintenance of Debt Equity Ratio

8) While granting a credit facility every NBFI shall ensure that the total long term debt-equity ratio of the borrower does not exceed 60:40 except in cases where the Government Schemes provide for a different debt-equity ratio in which case the one fixed by the Government shall apply. It should also be ensured that current liabilities of the borrower do not exceed his current assets.

Limit On HBFI's Exposure

9) Total exposure of a NBFI to a single borrowing entity or group shall not exceed 20% of its equity. In the case of listed companies, exposure shall not exceed 20% of total assets of the NBFI.

Margin Against Facilities

10) Following minimum margins shall be maintained against various facilities:

i) Guarantees: All guarantees except those specified below, will be backed by 100% realizable securities.

a) For issue of performance bonds, 100% cover of realizable securities may be waived by the NBFIs at their own discretion subject to minimum compulsory realizable security cover equivalent to 20% of the amount of the performance bond.

b) For issue of guarantees in respect of mobilization advance, 100% cover of realizable securities may be waived by the NBFIs at their own discretion subject to the following conditions:

i) Guarantees issued should contain a clause that the mobilization advance shall be released by the beneficiary through the guarantor NBFI only; and

ii) At the time of issuing such a guarantee the construction company should sign an agreement with the NBFI that releases out of mobilization advance would be covered by them by realizable assets.

c) For bid bonds issued on behalf of domestic consultant firms bidding for international contracts where the consultant fees are to be received in foreign exchange, the requirement of 100% cover by realizable securities may be waived at the discretion of the NBFIs.

d) Relaxation provided in (c) above, would also be admissible to all suppliers of goods and services bidding against International Tenders.

ii) Advance Against Shares: No NBFI shall allow facilities against its own shares or shares of its associated companies or shares of companies not listed on the Stock Exchange. Facilities against shares of other listed companies would be subject to the following margins:

a) Where market value does not exceed the face value: 20%

b) Where market value exceeds the face value but does not exceed twice the face value: 40%

c) Where market value exceeds twice the face value: 50%

d) No NBFI shall hold shares in any Company whether as pledgee, mortgagee of absolute owner, of an amount exceeding thirty percent of the paid-up share capital of that company or thirty percent of its own paid-up share capital and reserves whichever is less.

iii) Deposit Certificates: These will be subject to a margin of 20%

iv) Facilities Against Stocks:

Raw Cotton: 25%
Cotton Yarn: 25%
Edible Oil: 25%
Sugar (To Sugar Mills): 25%
Industrial Raw Material:
Imported: 25%
Indigenous: 30%
Other Stocks: 25%

Facilities To Small Entrepreneurs

11) At least 5% of the credit facilities shall be to small entrepreneurs. In the case of Housing Finance Companies, at least 5% facilities shall be in the form of facilities not exceeding Rs. 125,000 per borrower.

Focussing Attention On Principal Lines of Business

12) Every NBFI shall hold not less than seventy percent of its assets in the form of its principal lines of business.

Restrictions On Certain Types of Transactions

13)

i) NBFIs shall not provide any accommodation fund based or otherwise, to their Directors, Chief Executives 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. Facilities allowed by the NBFIs to their Chief Executives as part of their remuneration will be exempt.

ii) No NBFI shall allow unsecured facilities or facilities secured only by guarantees. Facilities provided against bank guarantees, the end use of which will be verified by the NBFI to be productive will be exempt.

iii) No NBFI shall allow facilities for speculative purposes.

iv) NBFIs shall not without the approval in writing of the State Bank of Pakistan enter into leasing, renting, purchasing or selling transactions with their directors, officers, employees or persons who either individually or in concert with close relatives beneficially own 10 percent or more either of the equity or other securities with voting rights of the transacting NBFI.

v) No NBFI shall hold, deal or trade in real estate except that in use of the NBFI itself. In the case of Housing Finance Companies, property acquired from a borrower in consequence of his failing to meet his obligations to Housing Finance Company would be exempt from this regulation.

Provisions For Non-Performing Assets

14) Every NBFI shall follow prudential guidelines in the matter of classification of its assets and provisioning there against. These are given hereunder:

Guidelines for Classification of Short Term Facilities

Classification	**Determinant**	**Treatment of Income**	**Provisions to be Made**
OAEM (Other Assets Especially Mentioned)	Where mark-up/interest or principal is overdue (past due) by 90 days from the due date	Unrealized mark-up/interest to be put in Suspense Account and not be be credited to Income Account	Provision of 2% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a court of law.
Substandard	Where mark-up/interest or principal is overdue by 180 days or more from the due date.	As above	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a court of law.

Guidelines for Classification of Short Term Facilities

Classification	Determinant	Treatment of Income	Provisions to be Made
Doubtful	Where mark-up/interest 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 less the amount of liquid assets realizable without recourse to a court of law
Loss	a) Where mark-up/interest or principal is overdue beyond two years from the due date	As above	Provision of 100% of the outstanding balance of principal
	b) Where Trade Bills (import, export or inland bills) are not paid/adjusted within 180 days of the due date	As above	As above

Liquid asset means realizable amount of bank deposits, certificates of deposit, government securities, shares of listed companies, NIT Units, Certificates of Mutual funds, inventories pledged to the Bank with possession with 'perfected lien' duly supported with flawless documentation.

Guidelines for Classification of Long Term Facilities

Classification	Determinant	Treatment of Income	Provisions to be Made
OAEM (Other Assets Especially Mentioned)	Where installments of principal or interst/mark up is overdue (past due) by 180 days or more from the due date	Unrealized mark up/interest to be put in Suspense Account and not be credited to Income Account	Provision of 2% of the difference resulting from the outstanding balance or principal less the amount of liquid assets realizable without recourse to a court of law

Guidelines for Classification of Long Term Facilities

Classification	Determinant	Treatment of Income	Provisions to be Made
Substandard	Where installment of principal or interest/mark-up is overdue by one year or more	As above	Provision of 25% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a Court of Law
Doubtful	Where installment of principal or interest/mark-up is overdue by two years or more	As above	Provision of 50% of the difference resulting from the outstanding balance of principal less the amount of liquid assets realizable without recourse to a court of law.
Loss	Where installment of principal or interest/mark-up is overdue by three years or more	As above	Provisions of 100% of the outstanding balance of principal.

Liquid asset means realizable amount of bank deposits, certificates of deposits, government securities, shares of listed companies, NIT Units, Certificates of Mutual Funds, inventories pledged to the Bank with possession with 'perfected lien' duly supported with flawless documentation.

Submission of Statistical Returns

15) Every NBFI shall submit returns prescribed below as per prescribed format attached:

Title of Return	**Periodicity**	**Period for Submission**
Weekly statement of affairs (per NBFIs' own format) as on week ended Thursday the ____of ____1992	To be submitted weekly	Within four days of the date to which the return relates
Statement showing liquidity position	Weekly	Within four days of the date to which the return relates
Statement showing equity and liability	Monthly	Within seven days of the date to which the return relates
Statement showing equity and contingent liability	-do-	-do-
Distribution of deposits/COIs by maturity	Quarterly	Within 15 days of the date to which the return relates.
Distribution of deposits by number of accounts	-do-	-do-
Statement showing sources of borrowing and their maturity	-do-	-do-
Ratewise analysis of borrowing	-do-	-do-
Ratewise analysis of advances	-do-	-do-
Constituent wise break up of advances	-do-	-do-
Statement of advances to small borrowers	-do-	-do-
Sector/Industry-wise statement of advances	-do-	-do-
Foreign and local currency loan Sector/Industry-wise statement of advances	-do-	-do-

Title of Return	Periodicity	Period for Submission
Statement showing rescheduling of financial assistance	-do-	-do-
Classification of advances by security pledged	Quarterly	Within 15 days of the date to which the return relates
Statement of disbursements made	-do-	-do-
Statement showing disbursement of foreign and local currency loan made	-do-	-do-
Statement of defaults against contingent liabilities	-do-	-do-
Statement showing typewise break-up of contingent liabilities	-do-	-do-
Statement of Recovery	-do-	-do-
Statement showing recovery of foreign and local currency	-do-	-do-
Rate of return on various types of deposits/ COIs	Half Yearly	-do-
Statement showing position of classified short term facilities to private sector	Annually	-do-
Statement showing position of classified short term facilities to private sector	-do-	-do-
Statement showing position of classified long term facilities to public sector	-do-	-do-
Statement showing position of classified long term facilities to private sector	-do-	-do-

Removal of Records

16) No NBFI shall remove from Pakistan and State of Azad Jammu and Kashmir to a place outside Pakistan and State of Azad Jammu and Kashmir any of its records or documents relating to its business without the prior permission in writing of State Bank of Pakistan. The records taken out of Pakistan and State of Azad Jammu and Kashmir by the officers or the organization in the discharge of their official duties will be exempt.

Audit and Submission of Accounts

17. Every NBFI shall submit duly audited accounts to the State Bank of Pakistan within a period of four months after the end of its accounting year and shall comply with the following conditions with respect to the appointment of auditors:

a) A person shall not be qualified for appointment as an auditor unless he is a Chartered Accountant within the meaning of Chartered Accountants Ordinance, 1961 (X of 1961).

b) An auditor shall hold office for a period of not less than three consecutive years and shall not be removed from the office before the expiry of that period except with the prior approval of the State Bank of Pakistan. In view of the provision of appointing auditors with the approval of Registrar Modarabas, this provision shall not apply to Modarabas.

c) The SBP may from time to time lay down guidelines for the audit, and the auditors shall be bound to follow those guidelines.

The SBP may require special audit of any NBFI in addition to regular inspection by the SBP, at any time and may appoint special auditors. The cost of such audit shall be borne by the NBFI.

Restriction On Election and Appointment

18) No person shall be elected or appointed as a director, an officer or an employee of an NBFI who;

a) has been convicted of an offence involving frauds, breach of trust or moral turpitude, or

b) has been adjudged as insolvent or has suspended payment of his debts or has compounded with his creditors.

Places of Business

19) No NBFI shall open further places of business without the prior permission in writing of the State Bank of Pakistan.

Code of Conduct

20) Every NBFI shall become a member of an association constituted in consultation with the State Bank of Pakistan. Such Association shall frame a code of conduct for their members and ensure compliance therewith.

Internal Audit

21) All NBFIs shall have an Internal Audit Department. The Head of this Department will report to the Chief Executive Officer directly. He will be interalia, responsible for compliance with these regulations.