

Provisioning Policy for Exposure of Funds under management of HBL Asset Management Limited

1. Introduction

The Securities and Exchange Commission of Pakistan (SECP) vide its Circular No. 1 dated January 6, 2009 prescribed the criteria for making provision against non performing debt securities held by Collective Investment Schemes (CIS). Further in continuation of above circular SECP vide its Circular No. 13 dated May 04, 2009 has made it mandatory for all Asset Management Companies to formulate a comprehensive provisioning policy for making any additional provision over and above the required provision as led out in the Circular No. 1 dated January 6, 2009 against debt securities or any other exposure held by CIS.

In this connection, this policy outlines procedure for making provision against exposure of Funds under the management of HBL Asset Management Limited.

Exposure means investments of Funds in:

- Debt Securities including Term Finance Certificates, Sukuk, Advance against Term Finance Certificates/Sukuk, Commercial Papers or any other debt security by whatever name called; and
- Other exposures including Certificates of Investment, Certificates of Deposits, Letter of Placement and other money market placements/transactions/instruments.

2. Criteria for Classification as Non Performing exposure

Any exposure shall be classified as non-performing, if the principal and/or profit/interest is past or overdue by 15 calendar days from the due date.

3. Provisioning Requirements against Non Performing exposure

3.1. Debt Securities

All non-performing **investment grade** debt securities whether secured or unsecured shall be provided for in accordance with the following criteria from the day of classification as non performing:

(Table A)

Effective Day for Provisioning	Minimum Provision as a percentage of outstanding Principal amount	Cumulative Provision
90 th day	20%	20%
180 th day	10%	30%
270 th day	15%	45%
365 th day	15%	60%
455 th day	40%	100%

All non-performing, **non- investment grade** debt securities whether secured or unsecured shall be provided for in accordance with the following criteria from the day of classification as non performing:

(Table B)

Effective Day for Provisioning	Minimum Provision as a percentage of outstanding Principal amount	Cumulative Provision
90 th day	25%	25%
180 th day	05%	30%
270 th day	15%	45%
365 th day	15%	60%
455 th day	40%	100%

In addition to the minimum provision prescribed above, any installment of principal amount in arrears during the period of non-performance shall also be fully provided. Accordingly for the purpose of applying percentage of provision as per above table principal amount shall not include overdue principal.

Any modification to the Circular No. 1 of 2009 dated January 6, 2009 by SECP from time to time will be deemed as a modification in the provisioning policy.

In addition to the time-based criteria prescribed in Tables ‘A’ & ‘B’, a higher provisioning can be made if circumstances warrant such provision (additional provisioning), subject to the approval of the Board of Directors and disclosure in periodical financial statements.

Following procedure will be applied for additional provisioning:

- Fund Manager/Risk Manager will propose additional provisioning to the Investment Committee;
- Investment Committee will evaluate the proposal and give recommendations to the Board of Directors;
- The Board of Directors will approve the additional provisioning; and
- Disclosure about provisioning will be made in the relevant periodical financial statements.

3.2. Other Exposure

All other **secured** non-performing exposure shall be provided for in accordance with the following criteria from the day of classification as non performing:

(Table C)

Effective Day for Provisioning	Minimum Provision as a percentage of outstanding Principal amount	Cumulative Provision
90 th day	20%	20%
180 th day	20%	40%
270 th day	20%	60%
365 th day	20%	80%
455 th day	20%	100%

All other **unsecured** non-performing exposure shall be provided for in accordance with the following criteria from the day of classification as non performing:

(Table D)

Effective Day for Provisioning	Minimum Provision as a percentage of outstanding Principal amount	Cumulative Provision
90 th day	25%	25%
180 th day	25%	50%
270 th day	25%	75%
365 th day	25%	100%

In addition to the time-based criteria prescribed in Table 'C' & 'D', a higher provisioning can be made if circumstances warrant such provision (additional provisioning), subject to the approval of the Board of Directors and disclosure in periodical financial statements.

Following procedure will be applied for additional provisioning:

- Fund Manager/Risk Manager will propose additional provisioning to the Investment Committee;
- Investment Committee will evaluate the proposal and give recommendations to the Board of Directors;
- The Board of Directors will approve the additional provisioning; and
- Disclosure about provisioning will be made in the relevant periodical financial statements.

4. Provisioning Requirements against performing exposure

Provisioning against performing exposures shall be made after evaluation of the exposure and if circumstances indicate such provisioning, subject to the prior approval of the Board of Directors and disclosure in periodical financial statements.

The provisioning against performing exposure shall be proposed after thorough due diligence and considering factors including the following:

- Significant deterioration in the financial/operational conditions of the issuer/guarantor;
- Strong market news that the borrower can be bankrupt or go to financing institutions for restructuring;
- Deterioration of key financial ratios;
- Down grade in credit rating of the instrument/issuer/guarantor;
- Observable data that indicate that there is a measurable decrease in cash flows of the issuer/guarantor which can effect timely payment of profit/interest or principal;
- Crisis in the industry in which the issuer/guarantor operates; and
- Introduction of government policy which adversely affect the issuer/guarantor or the industry in which the issuer/guarantor operates.

Following procedure will be applied for provisioning against performing exposure:

- Fund Manager/Risk Manager will propose provisioning against performing exposure with rationale to the Investment Committee;
- Investment Committee will evaluate the rationale of the proposal and give recommendations to the Board of Directors;
- The Board of Directors will approve the provisioning against performing exposure; and
- Disclosure about provisioning will be made in the relevant periodical financial statements.

On approval of the Board of Directors, a performing exposure shall be classified as non performing.

5. Suspension and reversal of interest/profit

Accrual of the profit/interest shall be suspended from the first day the interest/profit payment falls due and is not received taking into account following:

- cheque for the profit/interest payment received from the issuer/counterparty but not realized shall be deemed to be received and accrual of the profit/interest shall only be suspended from the day the intimation from trustee for dis honorement is received;
- cheque for the profit/interest payment received from the issuer/counterparty, however the issuer/counterparty has requested not to lodge cheque for clearance, the accrual of the profit/ interest shall only be suspended from the day the request from issuer/counterparty for not lodging a cheque is received.

All interest / profit recognized in the books of the fund shall be reversed immediately once a security is classified as non performing, and shall be put in Suspense Account and shall not be credited to Income Account except when realized in cash.

6. Reclassification of exposure and Reversal of provision

The non-performing exposure shall only be reclassified as performing once all the arrears have been received in cash and regular payments (interest/profit as well as principal) for the next two installments have been received.

The provision made for the principal amount in accordance with the minimum time based criteria as specified in tables 'A', 'B' 'C' and 'D' shall be reversed in the following manner:

- Where the provision of principal was made due to the interest/profit defaults only, 100% of the provision shall be reversed upon reclassification of the exposure as performing.
- Where the provision of principal was made due to the default in both principal and interest/profit payments, 50% of the provision shall be reversed on receipt of the first regular payment and 50% on receipt of second regular payment.

Where the provisioning is made in excess of the time based criteria as specified in tables 'A', 'B' 'C' & 'D' or against performing exposure it can be reversed in the following manner to the extent that the remaining provision meets the minimum time based requirements if any.

- Fund Manager will propose with justification for reversal of provisioning to the Investment Committee;
- Investment Committee will evaluate the proposal in detail and give recommendation to the Board of Directors for their post facto approval;

- The Board of Directors will approve the reversal of provisioning; and
- Disclosure about reversal of provisioning will be made in the relevant periodical financial statements.

The rescheduling / restructuring of non-performing exposure shall not change the status of classification of exposure as non performing, unless the terms and conditions of rescheduling / restructuring are fully met for a period of at least one year (excluding grace period, if any) from the date of such rescheduling / restructuring. Further, the unrealized profit/interest on such exposure (held in suspense account) shall not be taken to profit & loss statement unless actually realized in cash.

7. Write-off of fully provided exposure

Fully provided exposures shall be maintained for period of two years, thereafter the exposures (other than those in recovery suits) may be written off after obtaining specific approval of the Board of Directors.

8. Disclosure

This policy shall be disclosed/disseminated to all existing and prospective unit holders, trustee of Funds and the SECP. It shall also be disseminated through company website.

The provisioning made in the light of this policy shall be disclosed in the quarterly, half yearly and annual financial statements of the Funds.