POLICY FOR PROVISIONING OF DEBT SECURITIES

AND

OTHER FIXED INCOME EXPOSURES

AL MEEZAN INVESTMENT MANAGEMENT LTD

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Version History

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Background

- SECP, vide its circular # 1 dated January 06, 2009 (Annexure II) and two additional Circulars (Circular # 6 dated March 06, 2009 and Circular # 3 dated January 20, 2010) had prescribed the criteria for making provisions against non performing debt securities held by the Collective Investment Schemes (CIS). In continuation to this, Circular # 13 dated May 04, 2009 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 laid out in the Circular # 1 of 2009.

- Later in 2012, SECP issued Circular # 33 dated October 24, 2012 pertaining to the matter of provisioning criteria, which replaced the Annexure II of Circular # 1 of 2009 and its ensuing two circulars (Circular No. 6 of 2009 dated March 6, 2009 and Circular No. 3 of 2010 dated January 20, 2010) on this matter.

- Major changes in the provisioning requirements brought about by this new circular(circular 33 of 2012) are the following:

  - The time based criteria whereby the number of days over which 100% provisioning was supposed to be carried out has been changed from 455 days to 815 days.

  - Reclassification of debt securities

    - Criteria clearly separated for non-performing securities and rescheduled/restructured non-performing securities

    - For rescheduled/restructured non-performing securities, a new requirement has been added whereby the terms and conditions of rescheduling/restructuring shall have to be complied for one year.

- Presented hereunder is the revised/updated provisioning policy of Al Meezan Investment Management Limited aligned with the requirements of this latest circular # 33 of 2012 dated October 24, 2012. The salient features of this policy are:

  - Scope of the policy
  - Eligibility criteria to be classified as a debt security
  - Policy for classification as a non-performing exposure
  - Policy for making time based provisioning for securities
  - Policy for suspension of markup/profit
  - Policy for excess provisioning at AMC's Management's discretion
  - Policy for reclassification

- For non-performing assets
- For rescheduled/restructured non-performing assets

  - Policy for reversal of provisioning
  - Policy for provisioning of exposures other than those classified as debt securities

PROVISIONING POLICY

1. Scope of this Provisioning Policy

This policy shall cover the provisioning requirements of all fixed income funds under the management Al Meezan Investment Management Limited and shall include the Pension and Balanced Funds as well.

2. Eligibility criteria to be classified as a debt security

For the purpose of this Policy a "debt security" means any security issued by a company or a body corporate for the purpose of raising funds in the form of redeemable capital and includes term finance certificates, bonds, debentures, Sukuks, commercial papers, certificate of investment (COI), certificates of deposits (COD) certificate of Musharika (COM) and placements with banks.

3. Criteria for classification as a non-performing exposure

A debt security shall be classified as non-performing, if the interest and / or principal amount is overdue by 15 calendar days from the due date.

4. Policy for making time based provisioning for securities

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

Effective day for Provisioning	Minimum Provision as % of book value (outstanding principal amount)	Cumulative Provision
90th day	20%	20%
180th day	10%	30%
270th day	10%	40%
365th day	10%	50%
455th day	10%	60%
545th day	10%	70%
635th day	10%	80%
725th day	10%	90%
815th day	10%	100%

The AMC may exercise discretion with respect to the timing for creating the requisite provision such as immediately on the day of classification as non-performing or spreading it over a number of days as deemed appropriate in the best interest of the unit holders. However, the minimum provision on effective day shall be in accordance with the schedule given above.

Where a debt security immediately preceding its classification as non-performing is valued at a discount to its outstanding principal amount, such discount may be accounted for while arriving at the minimum provision. However, if any such discount exceeds the requisite provisioning, the excessive discount shall not be written back and debt security shall be carried at the existing value upon classification as non- performing.

In addition to the minimum provision mentioned above, any installment of principal amount due during the period of non-performance shall also be fully provided.

If the rating of a security falls below investment grade, a 25% provision/discount shall be recognized. If the non-investment grade security becomes non-performing, the provisioning shall be accounted as per the time based criteria mentioned above.

5. Criteria for suspension of markup

- The accrual of interest / profit shall be suspended from the first day the interest / profit payment falls due and is not received.

- All interest / profit accrued and recognized in the books of the CIS shall be reversed immediately once a debt security is classified as non-performing.

- In case a CIS has received all arrears of interest and the debt security has not been reclassified as performing, the suspension of interest shall continue.

6. Policy for excess provisioning at AMC's Investment Committee's discretion

The Investment Committee shall decide if provisioning in excess of the time based criteria specified by the subject circular, is required. The Investment committee will decide after thorough due diligence and will consider the following factors:

- Significant financial difficulties of the issuer;
- It is probable that the issuer will breach a contract, such as default or delinquency in interest or principal or principal payment;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties faced by the issuer;
- Deteriorating credit history;
- Deterioration of key financial ratios;
- Deterioration of historical as well as forecasted cash flows;
- Worsening operating conditions;
- Adequacy of the security, its realizable value and documentation covering the exposure;
- An expected credit rating down grade of the issuer and/or the particular debt security;
- A credit rating down grade of the issuer and/or the particular debt security;
- Observable data that indicates that there is a measurable decrease in cash flows of the issuer; and
- Economic condition and outlook and its particular emphasis on the industry in which the issuer operates.

7. Criteria for reclassification

a. <u>For Non-Per/Orming Securities</u>

The debt security shall only be reclassified as performing once all the arrears have been received in cash and debt security is regular on all payments (interest as well as principal for the next two installments).

b. <u>For rescheduled/restructured non-per/orming securities</u>

The following conditions need to be met:

- The terms and conditions of rescheduled/restructured debt security are fully met for a period of at least one year;
- All the arrears (till the date of restructuring) have been received in cash;

- An amount equivalent to two installments (excluding grace period, if any) as per original repayment term (before rescheduling) are paid in cash;

However, during rescheduling/restructuring period, creation of additional provisioning against such debt security may be stopped. If the debt security subsequently does not perform as per the rescheduling/restructuring agreement, the debt security shall be treated as non-performing from the date of its original default.

8. Policy for reversal of provisioning

- The unrealized markup amount reversed shall be written back to income up to the extent it is received in cash.

- The provision made for principal amount shall be written back to the extent it is received in cash and the remaining provision shall cover the minimum provision required. The full provision shall be reversed when the debt security is reclassified as performing.

- Where the Investment Committee has provided for a security in excess of the requirements of Circular # 33 of 2012, it can be reversed on the decision of the Investment Committee after reviewing each such case in detail and to the extent that it meets the minimum time based requirements of the circular. However, such a reversal can only be made after at least one (1) month from the application of the excess discount

9. Policy for provisioning of exposures other than those classified as debt securities

Certain exposures held by the CIS may be classified as non-performing by the Investment Committee when the principal and/or the profit is overdue by 30 days. Such a non-performing exposure shall be provided for according to the following minimum time based provisioning guidelines;

Effective Day for Provisioning	Minimum Provision as % of book value (outstanding principal amount)	Cumulative Provision
90th day	20%	20%
180th day	10%	30%
270th day	10%	40%
365th day	10%	50%
455th day	10%	60%
545th day	10%	70%
635th day	10%	80%
725th day	10%	90%
815th day	10%	100%

- Upon completion of the 30 day period, Profit / Mark-up (which is not received in cash) already accrued on any exposure classified as NPA shall be provided for.

- Accelerated provisioning, if the situation warrants, is allowable as well at the discretion of the Investment Committee. The pace of such excess provisioning may be varied based on considerations such as progress on recoverability / restructuring discussions with the counter- party – however, in all cases, the minimum provisioning based on the above time based schedule will require adherence.

- No general provisions shall be made against exposures held by the CIS, unless specially required by the regulations.

Criteria for Reversal of Provisions and Reclassification of non-performing exposures as performing for exposures other than debt securities;

- Where the provision is made against such exposure, it can be reversed on the decision of the Investment Committee after reviewing each such case in detail. However, such a decision can only be made after at least one (1) month from the date when it was provided for.

Where any exposure classified as non-performing undergoes a successful restructuring with the CIS or group of creditors, the exposure shall be treated as performing if the exposure fulfills all the requirements and formalities of such restructuring for a period of three (3) months from the date of restructuring. After completion of such period, any provision and suspended markup shall be written back to income in full to the extent and as per the terms and conditions of the restructuring arrangement. Thereafter, the CIS shall accrue profit / mark up for further periods as per the terms and conditions agreed upon in the restructuring arrangement.

MAINTENANCE AND UPDATION OF POLICY

The basic responsibility of maintenance and updating of this policy resides with the Chief Investment Officer. This Policy shall be reviewed on a periodic basis but at least once in three years and shall be updated, if required.

Subsequent updates/ amendments to the policy shall be approved by the Board. In case of no change, the policy shall even then will be placed before the Board for ratification.