

# Lending and taking in Pakistan: overview

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## OVERVIEW OF THE LENDING MARKET

### 1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

The main trends and important developments in the lending market in the past 12 months are as follows:

- During the current fiscal year, the State Bank of Pakistan (SBP) reduced the policy rate by a cumulative 7% with effect from 25 May 2015, which is the lowest rate in the last 42 years, reflecting improved economic conditions.
- Following a decline in the policy rate, the weighted average lending rate on fresh disbursement has also reduced from 10.53% to 9.31% in March 2015. Similarly, the weighted average deposit rate offered on fresh disbursements has also reduced from 5.8% to 5.22 % in March 2015.

## FORMS OF SECURITY OVER ASSETS

### Real estate

### 2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

#### Real estate

The term real estate means:

- Land.
- Buildings.
- Fixtures.
- Plants.
- Machinery.

#### Common forms of security

A common form of security granted over real estate is a *pari passu* charge over real estate property. The term *pari passu* charge is used when there is more than one charge holder willing to proportionally share the first charge over a borrower's assets. For example, company A borrows from Bank H and a loan is secured against the first charge over fixed assets. Company A then wishes to take out another loan from Bank K, which will be secured against a first charge over fixed assets. Here Bank H and Bank K may be willing to share the first charge over the fixed assets on a *pari passu* (proportional) basis.

Mortgage charges over real estate property are also a common form of security. The Transfer of Property Act 1882 provides that mortgage charges are as follows:

- First *pari passu* charge over fixed assets.

- Simple mortgage. Where, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage, and agrees, expressly or impliedly, that, in the event of his failing to pay according to his contract, the mortgagee has a right to cause the mortgaged property to be sold and the proceeds of sale to be applied, so far as may be necessary, in payment of the mortgage-money, the transaction is called a simple mortgage and the mortgagee a simple mortgagee.
- Mortgage by conditional sale. The transaction is called a mortgage by conditional sale where the mortgagor seemingly sells the mortgaged property on condition that:
  - on default of payment of the mortgage money on a certain date the sale becomes absolute;
  - on the payment being made the sale becomes void;
  - on the payment being made the buyer transfers the property to the seller.

This is provided that no such transaction is deemed to be a mortgage, unless the condition is embodied in the document that effects or purports to effect the sale.

- Usufructuary mortgage. The transaction is called an usufructuary mortgage and the mortgagee an usufructuary mortgagee where the mortgagor:
  - delivers possession (or expressly or by implication binds himself to deliver possession) of the mortgaged property to the mortgagee;
  - authorises the mortgagee to retain possession until payment of the mortgage-money; or
  - authorises the mortgagee to receive the rents and profits accruing from the property (or any part of the rents and profits) and to appropriate the same in lieu of interest or in payment of the mortgage-money, or partly in lieu of interest or partly in payment of the mortgage-money.
- English mortgage. Where the mortgagor binds himself to repay the mortgage on a certain date, and transfers the mortgaged property absolutely to the mortgagee, but subject to a proviso that he will retransfer it to the mortgagor on payment of the mortgage as agreed, the transaction is called an English mortgage.
- Mortgage by deposit of title deeds. Where a person in a certain town or city (or specific town or city that the state government is concerned about) can, by notification in the *Official Gazette*, deliver to a creditor or his agent documents of title to immovable property, with the intention to create a security, the transaction is called a mortgage by deposit of title deeds.
- Anomalous mortgage. This concept is not common.

#### Formalities

The most common forms of security are created and perfected by the following procedure:



The mortgage or charge documents must be:

- In writing.
- Signed by at least two witnesses.
- Stamped in accordance with the stamp laws.
- Supported by a resolution of its board of directors and signed by the authorised directors if it has executed a charge document.

The mortgage or charge documents must be registered under the Registration Act 1908. If the mortgage or charge is created over the assets of a company, it must be registered with the Securities and Exchange Commission of Pakistan (SECP).

### **Tangible movable property**

#### **3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?**

##### **Tangible movable property**

Tangible movable property means:

- Plants.
- Machinery.
- Trading stocks.
- Ships.
- Aircrafts.
- Vehicles.
- Furniture.
- Carriages.
- Horses.
- Stable furniture.
- Motor cars and accessories.
- Garden effects.
- Domestic animals.

##### **Common forms of security**

There are two common forms of security for tangible movable assets:

- **Bank lien.** A bank can have a lien on the amounts in a bank account. The amounts in credit of the bank account can be charged and the receivables from the account can be assigned.
- **Hypothecation.** This means a charge or pledge over the movable property such as:
  - aircrafts;
  - ships;
  - equipment;
  - intellectual property;
  - inventories;
  - leases;
  - mineral interests;
  - animals;
  - crops;
  - promissory notes; and

- chattel papers.

##### **Formalities**

Charges over tangible movable property must be:

- In writing.
- Signed by at least two witnesses.
- Stamped in accordance with the stamp laws.
- Registered with the Registrar of the Companies of the Exchange Commission of Pakistan within 21 days of its creation.

The prescribed particulars of the mortgage or charge, together with a copy of any instrument verified in the prescribed manner by which the mortgage or charge is created or evidenced must be filed with the Registrar of the Companies within 21 days of its creation.

### **Financial instruments**

#### **4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?**

##### **Financial instruments**

The following types of financial instruments are available:

- Bonds.
- Share certificates.
- Deposit certificates.
- Market treasury bills.
- Commercial papers.

##### **Common forms of security**

The common forms of security for financial instruments are:

- **Bank lien.** A bank can have a lien on the amounts in a bank account. The amounts in credit of the bank account can be charged and the receivable from the account can be assigned. This medium is applicable to deposit certificates.
- **Hypothecation.** Hypothecation or charges can be over share certificates, market treasury bills and commercial papers.

##### **Formalities**

Charges over financial instruments must be registered with the Registrar of Companies at the Securities and Exchange Commission of Pakistan. The prescribed particulars of the mortgage or charge, together with a copy of any instrument verified in the prescribed manner by which the mortgage or charge is created or evidenced must be filed with the Registrar for registration within 21 days after the date of its creation. Failure to register renders the charge void against the liquidator and any creditor of the company.

### **Claims and receivables**

#### **5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?**

##### **Claims and receivables**

The most common types of claims and receivables include:

- Debts and other rights to the payment of money.
- Rights to require performance of a non-financial obligation.

- Rights to claim under insurances.

### Common forms of security

The most common forms of security are as follows:

- Mortgage.
- Charge.

### Formalities

Charges over claims and receivables of a company must be registered with the Registrar of Companies. The prescribed particulars of the mortgage or charge, together with a copy of any instrument verified in the prescribed manner by which the mortgage or charge is created or evidenced, must be filed with the Registrar for registration within 21 days after the date of its creation. Failure to register renders the charge void against the liquidator and any creditor of the company.

### Cash deposits

#### 6. What are the most common forms of security over cash deposits? How are they created and perfected?

### Common forms of security

See Question 4.

### Formalities

See Question 4.

### Intellectual property

#### 7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

### Intellectual property

The most common types of intellectual property are:

- Patents.
- Trade marks.
- Copyrights.
- Designs.

### Common forms of security

The most common form of security over intellectual property is a hypothecation. A hypothecation is a charge that can be created over intellectual property.

### Formalities

The following formalities are required:

- The charge must be in writing.
- The charge must be signed by or on behalf of assignor.
- The charge must normally be executed as a deed.

### Problem assets

#### 8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

There are no particular types of property that cannot be mortgaged. However, a hypothecation charge, which is regarded as

a fixed charge, can be created on the present and future assets of a borrower. The borrower can deal with the hypothecated goods in the ordinary course of business, so long as it replaces the goods sold or consumed with like goods, which then automatically become part of the hypothecated goods.

### Future assets

A floating charge over future assets is usually created by an instrument known as a deed of floating charge, which is registered with the Securities and Exchange Commission of Pakistan (SECP) if the borrower is a company. A floating charge on immovable property requires registration under the Registration Act 1908.

### Fungible assets

A floating charge over fungible assets such as oil and metals is usually created by an instrument known as a deed of floating charge (see above, *Future assets*).

## RELEASE OF SECURITY OVER ASSETS

#### 9. How are common forms of security released? Are any formalities required?

The security that is being released is held over the assets of a corporate borrower. The borrower must register the vacation of the security with the Securities and Exchange Commission of Pakistan (SECP) by completing and submitting the SECP Registration form, which corresponds to the particular type of security being vacated.

If the security is held over immovable property (for example, land, property or buildings) in the form of a registered mortgage, then the security is released by the security holder executing a deed of redemption and registering this with the Registrar of Properties.

## SPECIAL PURPOSE VEHICLES (SPVS) IN SECURED LENDING

#### 10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

In Pakistan it is not common to use SPVs.

## QUASI-SECURITY

#### 11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

The quasi-security structure is recognised.

### Sale and leaseback

In a simple sale and leaseback, the owner of equipment sells that equipment to a financier who leases the equipment back to the seller. The structure can vary as follows:

- The initial seller is a dealer, who on-sells to a financier, who leases back to the original seller.
- The financier lets the equipment back to another company in the seller's group, rather than to the original seller.

If (by following the simple structure summarised above) a purchaser of goods leases them back to their seller, the purchaser faces the following two key risks:

- The seller can give good title to the goods to a third party under section 26 of the Sale of Goods Act 1930.

- If the leaseback requires the seller to re-purchase the goods, or gives it an option to do so, the arrangement can be recharacterised as a loan secured on the goods, with the recharacterised security void if not registered at Companies House.

An individual that sells but retains possession of goods (or documents of title to those goods) after the sale can give title to those goods to anyone that receives them in good faith and without notice of the previous sale (*section 26, Sale of Goods Act 1930*). Section 26 does not apply if the seller does not continuously possess the goods from the time it sells them to the financier until it sells them to a third party. It is not completely clear how long an interruption of the seller's possession must last to prevent section 26 from applying.

Where the seller has an obligation or option to regain title to the goods it sold, by paying an option price or a final rental under a lease back, there is a risk a court will recharacterise this arrangement as a secured loan. However, generally the English courts are unlikely to recharacterise these transactions as secured loans without evidence that the parties did not intend the sale and leaseback documents to record their true intentions.

### Factoring

The concept of factoring is not recognised.

### Hire purchase

Under a hire purchase agreement (HPA), the owner of goods leases them to a lessee and grants the lessee an option to purchase the goods at the end of the lease. Conditional sale agreements (CSAs) are similar to HPAs. However, under a CSA, the lessee must take title to the leased equipment by paying the final rental under the CSA. HPAs and CSAs are not, of themselves, liable to recharacterisation as secured loans.

A lessor of a motor vehicle under an HPA or CSA faces the risk, under the Transfer of Property Act 1882 that its lessee can (in some circumstances) sell the vehicle, before the lessee has itself acquired title from the lessor, but can still give good title to the vehicle to an innocent purchaser. Vehicle lessors commonly register their ownership at a commercially run register to try to mitigate this risk.

A lessee of goods under a CSA can, in some circumstances, give good title to those goods to an innocent purchaser despite the lessee not having acquired title to them from its lessor.

Among other things, lessors under both HPAs and CSAs face the following two risks that are inherent in equipment leasing:

- The courts have a discretion (known as relief from forfeiture) to prevent the lessor from repossessing the leased equipment following a lessee default if (broadly) the lessee can show it is ready, willing and able to cure its breach of the lease. This risk is very low if the lease is an operating lease.
- Depending on, among other things, the lease's drafting, the lessor may not be able to recover all amounts expressed to be due from the lessee on a default termination of the lease if those amounts are penal. Those amounts are likely to be penal if they are found to be extravagant, exorbitant or unconscionable, or to impose a detriment on the lessee out of all proportion to the lessor's legitimate interests in the performance of the breached obligation. Broadly, the risk of a termination sum being regarded as penal is lower under a CSA than under an HPA.

### Retention of title

Under a simple title retention structure, the seller retains title to goods it sells until it receives their purchase price. Broadly, the courts enforce this arrangement and do not treat it as a registered secured transaction. The courts can treat more complex structures as unregistered secured financings (for example, structures that

involve title retention despite on-sales or in relation to products made from the initially sold goods).

## GUARANTEES

### 12. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are commonly used in the lending market. Generally, private companies and public companies can give downstream, upstream and cross-stream guarantees subject to their memorandum and articles of association permitting the same and subject to section 195 of the Companies Ordinance 1984.

Under section 195 of the Companies Ordinance, a public limited company (relevant company) cannot provide a guarantee or other security in connection with a loan made by any other person to, or to any other person by:

- Director of the relevant company.
- Director of a holding company of the relevant company.
- Director of any other private company of which a director of the relevant company is a director or member.
- A company whose directors are accustomed to acting in accordance with the directions of the directors of the relevant company.

Private limited companies can issue guarantees in favour of other companies except if the private limited company is a subsidiary of a public company. The restriction in section 195 of the Companies Ordinance does not apply to banks.

None of the above restrictions apply to any guarantee given or security provided by a private company (unless the private company is a subsidiary of a public company), a banking company or any holding company in respect of any loan made to its subsidiary (downstream guarantees).

## RISK AREAS FOR LENDERS

### 13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

#### Financial assistance

Under company law, a company cannot buy its own shares or shares of its holding company. No company limited by shares, other than a private company, not being a subsidiary of a public company, can give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with purchase made or to be made by any person of any shares in the company.

However, the law does not prevent the company from advancing or securing an advance to any of its salaried employees, including a chief executive who, before his appointment as such, was not a director of the company, but excluding all directors of the company, for purchase of shares of the company or of its subsidiary or holding company, if making or securing of such advance is a part of the contract of service of such employee.

#### Corporate benefit

A director of a company has a statutory duty to act in a way he considers is likely to promote the company's success. If a counterparty to a proposed transaction with a company knows, or ought to know, that the company's directors are breaching that duty in approving the transaction, the counterparty can lose the benefit of any rights, or interests in assets, it received under the transaction documents.



Lenders must be particularly aware of this when taking guarantees and third party security. If the borrower is a subsidiary of the surety, the "corporate benefit" for the surety is usually clear. In other situations, the benefit may be less obvious. Although it is a question of fact whether a transaction is likely to benefit a company, well-drafted board minutes setting out the perceived benefits of the transaction (sometimes together with a shareholder resolution approving the transaction) can usually help minimise the risk of a successful challenge.

### Loans to directors

A company can extend loans to its directors subject to the following limitations. The law states that no company (the lending company), must, directly or indirectly, make any loan to, or give any guarantee or provide any security in connection with a loan made by any other person to, or to any other person by:

- Any director of the lending company or of a company that is its holding company or any partner or relative of any such director.
- Any firm in which any such director or relative is a partner.
- Any private company of which any such director is a director or member.
- Any body corporate at a general meeting of which not less than 25% of the total voting power can be exercised or controlled by such director or his relative, or by two or more such directors together or by their relatives.
- Any body corporate, the directors or chief executive who are or is accustomed to act in accordance with the directions or instructions of the chief executive, or of any director or directors, of the lending company.

### Usury

There are usury laws, which prohibit the charging of usury. However, these are rarely enforced. With banks, the interest rates that banks lend to borrowers are linked to a recognised benchmark. This benchmark is usually the Karachi Inter-Bank Offer Rate (KIBOR) but can also be other benchmarks such as treasury bills and Pakistan Investment Bonds. Where lending is taking place in a foreign currency then LIBOR is also used as the benchmark for lending. Banks add a margin to these benchmarks.

### 14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

Environmental laws have no connection to the actions of a borrower or security provider.

## STRUCTURING THE PRIORITY OF DEBTS

### 15. What methods of subordination are there?

#### Contractual subordination

The concept of contractual subordination is recognised. Generally, creditors require the borrower to create a *first pari passu* charge in their favour where there are multiple creditors in whose favour the charge has been created. Here the security charge becomes subordinate if no objection certificates from the prior creditors are obtained. A charge can also be subordinate if it is created as a ranking or subordinate charge.

Priority of a security charge can be contractually varied and the contractual subordination provisions survive insolvency of a borrower incorporated in Pakistan. Subordination of debts is also recognised under the law.

#### Structural subordination

The concept of structural subordination is also recognised. It can be achieved where the senior creditor lends to a company (usually one of the operating subsidiaries where assets are held) which is lower in the group structure than the company (a holding company) into which the junior creditor lends. Junior creditors as creditors of a holding company effectively rank behind creditors of the operating subsidiaries lower down in the group structure. This is because where a holding company and its subsidiaries become insolvent, the creditors of the operating subsidiaries are paid out before any distribution is made to the holding company as shareholder in the subsidiary. Only if the holding company receives a distribution from the liquidator of a subsidiary will the holding company be able to meet the claims of its creditors from the proceeds realised from the subsidiaries.

#### Inter-creditor arrangements

Inter-creditor arrangements are commonly recognised. The typical parties normally include two or more creditors that are banking companies and they can through mutual agreement vary the terms of the loan agreement made with a borrower.

## DEBT TRADING AND TRANSFER MECHANISMS

### 16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

The concept of loan transfer is recognised. With finance agreements, a novation agreement in favour of a new financier is the least problematic mechanism for both bilateral as well as syndicated facilities. In syndicated facilities, security is usually created in favour of a security trustee or agent so that the security continues, even though the lenders can change due to the transfer of loans.

Other common mechanisms used for loan transfers by banks include assignment, transfer and participation offers, which are generally used where there is a partial transfer of rights and benefits.

The relevant parties enter into and execute the agreements, documents or instruments as required by the banks for giving further and full effect to the terms of the transfer or assignment including but not limited to execution of a novation agreement or a fresh financing agreement with the transferee or assignee.

In consumer finance, balance transfer finance facilities are commonly extended to borrowers from other banks that are used for transferring limits of personal loans, house financing and auto loans.

## AGENT AND TRUST CONCEPTS

### 17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

The concept of foreign agency arrangement is recognised under the Contract Act 1872. Under the law, any person can employ an agent to do anything for that person or engage in dealings on behalf of that person with third parties. The person employing the agent is known as the principal.

Although a principal usually employs an agent through a formal written agreement, the law does not require any form of formal writing (for example, a contract) in order for a principal to employ an agent. Where there is no formal written document governing the agency, the principal or agent relationship between the parties is inferred from their conduct and dealing with each other.

An agency is terminated when the principal revokes his authority or the agent indicates that he no longer wishes to continue to act as agent for the principal. The agency can also be terminated by the completion of the business for which the agent was employed.

The facility agent can enforce rights on behalf of the other syndicate lenders in the courts.

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#### 18. Is the trust concept recognised in your jurisdiction?

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Private trusts are regulated under the Trusts Act 1882. A trust is created when a person (the author) permits another (the trustee), by declaring his confidence in the trustee, to hold and deal with property or money (the trust property or trust money) for the benefit of a particular person or persons (the beneficiary). A trust can hold both immoveable property (for example, property or land) and moveable property (for example, money, securities or plant and machinery).

The Trusts Act 1882 imposes certain duties on the trustees such as the duty to:

- Fulfil the purpose of the trust.
- Take all action to preserve the trust property or money.
- Not act in any way that sets up or aids any title or ownership to the trust property or money that is adverse to the beneficiaries' interests.
- Deal with the trust property with due care.

The general principles of trusts under the Trusts Act 1882 were based on English principles of trust prevailing in 1882.

### ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

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#### 19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

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In the event of default by the borrower, the bank can file a suit in the banking court under the Financial Institutions (Recovery of Finances) Ordinance 2001 for recovery of the outstanding amount as well as sale of mortgaged or charged properties and other securities. Banking courts have exclusive jurisdiction in banking cases in the first instance. Appeals can be filed in the High Court with jurisdiction on the matter.

These proceedings are initiated by filing a plaint in the banking court. Where the borrower wishes to contest the case he must file an application for leave to defend the suit within 30 days or the service of summons upon him. The bank would then be required to file a reply to that application.

Thereafter, application for leave to defend is heard by the judge and where a prima facie defence is made out, the borrower is allowed to defend the suit.

The court then sets the issues (that is, the points for decision as well as evidence, both oral and documentary), which are recorded by the court. The lawyer for the parties then advance arguments in support of their respective cases and the judge in due course passes judgment.

Normally, if the suit is decreed in favour of the bank, the mortgaged or charged property or assets are sold through an officer of the court and the sale proceeds are paid to the bank. Where the sale proceeds of the mortgaged property are not

sufficient to satisfy the claim, the bank is entitled to attach and sell any other property.

Banks or financial institutions can take the benefit of the forced sale value of the pledged stocks, plant and machinery under charge, and mortgaged residential, commercial and industrial properties held as collateral against non-performing loans for calculating provisioning requirement.

#### Methods of enforcement

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#### 20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

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Methods of enforcement of certain types of securities include:

- **Lien.** If a lien is on an account maintained with the bank, the bank can exercise a set-off. If the account is maintained with another bank, the other bank can be required to pay over the deposit to the bank.
- **Pledge.** Enforcement is by notice to the pledgor and on failure of the pledgor to redeem, the bank can sell the assets directly or through a receiver, by private contract or public auction.
- **Hypothecation.** The bank can sell the assets itself or appoint a receiver to sell.
- **Mortgage.** The bank can sell the mortgaged property directly or through a receiver, by private contract or public auction.
- **Floating or fixed charge.** The bank can sell the charged property directly or through a receiver, by private contract or public auction.
- **Guarantee.** The bank can make a demand on the guarantee and where there is a failure to pay, the bank can file a recovery suit against the guarantor.
- **Assignment.** The bank must make a demand on the debtors, failing which it must institute recovery proceedings naming the borrower and the third parties.

Although the law allows banks to take direct recovery action, banks are generally averse to taking enforcement action without the sanction of a court order, for which they have to file legal proceedings. Legal proceedings protect the bank against counter claims by the borrowers.

#### Rescue, reorganisation and insolvency

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#### 21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

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Company rescue or reorganisation procedures outside of insolvency proceedings are dealt with under sections 284 to 287 of the Companies Ordinance 1984. Such reorganisation is achieved through a scheme of arrangement or amalgamation. A company must file a petition with the High Court for an order to hold an extraordinary general meeting where shareholders approve the business combination.

Once the shareholders have approved the combination, the company must make an application to the court for its approval on the scheme of arrangement, which sets out the particulars of the combination, including issues of:

- Property.
- Liabilities and debts of the companies.
- Share swaps.

- The continuation of any legal proceedings.
- Dissolution of (without winding up) one or both of the concerned entities.

The court does not sanction the merger unless it is satisfied that all material facts relating to the company have been disclosed, such as:

- The latest financial position of the company.
- The latest auditor's report on the accounts of the company.
- The pendency of any investigation proceedings in relation to the company.

There are other laws and regulations that govern reorganisation of companies in specific sectors such as banking companies and non-banking finance companies.

## **22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?**

A secured party has priority over unsecured creditors. Similarly, a registered charge takes priority over an unregistered charge, whether it is created prior or subsequent to the unregistered charge.

The company laws provide that any transfer by a company of its immovable or movable property including actionable claims, if made within a period of one year before the presentation of a petition for winding-up or the passing of a resolution for voluntary winding-up of the company, are void against the liquidator. However, the law exempts from the operation of the aforesaid rule, transfers of property made in the ordinary course of business or in favour of a purchaser in good faith and for valuable consideration. Contracts that fulfil these criteria are valid and binding on the liquidator even if made within one year of the presentation of a petition of winding-up. It has been held by the courts that contracts entered into even after the presentation of a winding-up petition can be validated by the court conducting the winding-up proceedings, if it considers it just and reasonable on the facts and circumstances of the case and if such validation does not prejudice the claims of the other creditors of the insolvent company.

The company laws further provide that where any part of the property of a company being wound up consists of, among other things, any unprofitable contracts or of any other property that is unsaleable or not readily saleable then the liquidator can, with the leave of the court at any time within 12 months after the commencement of the winding-up, disclaim the property (and the contract). In granting leave to disclaim, the court must satisfy itself that the contract places a heavy burden on the company in liquidation. Therefore, a liquidator is not released from performing his part of the bargain unless he can show extenuating circumstances. The law provides some relief to a party against whom the disclaimer operates and provides that any person injured by the operation of the disclaimer by a liquidator are deemed to be a creditor of the company to the amount of compensation or damages.

## **23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?**

The transactions involving loans, guarantees, or security interests that are not perfected, or subject to fraud or another irregularity can be made void.

## **24. In what order are creditors paid on the borrower's insolvency?**

On insolvency of a company, payments are made in the order of priority set out below. The order below not only includes different types of creditors but also the payments as may be made against other liabilities:

- Revenues, taxes, cesses and rates due from the company to the federal government.
- Salaries and wages of employees.
- Holiday remuneration and terminal benefits of employees.
- Insurance payable to employees and others.
- Contribution or other payments payable towards provident, pension, gratuity or other funds.
- Investigation expenses.
- Secured creditors.
- Legal charges.
- Remuneration to liquidator.
- Costs of winding-up.
- Preferential creditors.
- Debenture holders or other creditors having a floating charge of the assets of the company.
- Unsecured creditors.
- Preferential shareholders.
- Equity shareholders.

## **CROSS-BORDER ISSUES ON LOANS**

### **25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders?**

It has been assumed that "foreign lenders" means banks and other institutions that do not hold a licence to carry on banking business in Pakistan. The same rules and regulations apply to lending to branches of foreign banks holding a licence to those doing banking business in Pakistan and locally incorporated banks.

Under section 4(1) of the Foreign Exchange Regulation Act 1947, no person in, or resident in, Pakistan can borrow from abroad without the general or special permission of the State Bank of Pakistan. The State Bank has given general permission to various borrowers (including private sector entrepreneurs and companies) to obtain loans from parent companies or banks and financial institutions outside of Pakistan. Chapter XIX, Part B (Foreign Private Loans) of the Foreign Exchange Manual regulates when such loans can be taken advantage of by residents of Pakistan from foreign lenders. Alternatively, the borrower can apply for special permission from the State Bank of Pakistan to borrow funds from a foreign lender. The State Bank of Pakistan has granted general permission for certain categories of loans as follows:

- "Pay as you earn schemes" under which entrepreneurs in the private sector can negotiate loans from foreign banks and financial institutions for the import of plant and machinery for export-oriented industries either for the establishment of new industrial units or for balancing, modernisation, replacement and expansion of existing export-oriented units.

- "Repatriable foreign currency loans by foreign controlled companies" under which foreign controlled companies in Pakistan are permitted to borrow from banks and financial institutions abroad or from their head offices or from overseas branches in order to meet their working capital requirements.
- "Foreign currency loans for working capital and other purposes" under which firms and companies operating in Pakistan that are not foreign controlled (excluding banks) can benefit from loans from foreign lenders to meet their working capital requirements. Such loans can be repatriable or non-repatriable.
- "Foreign currency loans for financing exports" under which foreign lenders can extend short-term loans in foreign currency to exporters that have firm commitments with foreign buyers of the exported goods.
- "Foreign currency loans for authorised dealers" in which foreign lenders can lend to banks when such banks require short-term loans in the normal course of their business.

Foreign lenders can also lend to banks in the form of long-term loans in foreign currency provided such loans are approved by the State Bank of Pakistan.

Generally, if a foreign lender can extend a loan under a general permission, or the borrower has special permission to borrow from a foreign lender, then the granting of securities or guarantees in favour of the foreign lender is also permitted under the relevant general or special permission.

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## 26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

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### Restriction on Dealing in Foreign Exchange

Under section 5 of the Foreign Exchange Regulation Act 1947, no person in, or resident of Pakistan can deal in foreign exchange unless that person falls within any general or special exemptions from this rule granted by the State Bank of Pakistan. The restriction on dealing in foreign exchange includes:

- Making payments to the credit of someone resident outside Pakistan.
- Drawing, issuing or negotiating any bill of exchange or promissory note or acknowledgment of debt so that a right to receive payment is created in favour of someone resident outside of Pakistan.
- Placing any sum to the credit of someone resident outside of Pakistan.

### General Exemptions

General exemptions to the prohibition contained in section 5 of the Foreign Exchange Regulation Act, 1947 are granted by the State Bank of Pakistan and they exempt a particular class of persons or a particular type of transaction from the application of foreign exchange rules. These exemptions are contained in the Foreign Exchange Manual of the State Bank of Pakistan and are informed by the State Bank of Pakistan through foreign exchange circulars.

### Special Exemptions

Special exemptions from the general prohibition contained in section 5 of the Foreign Exchange Regulation Act 1947 are

available when the State Bank of Pakistan has not granted any general exemption to a class of persons or transactions but has allowed a person to make an application for a specific person or transaction to be exempted from foreign exchange rules, or for a rule to be relaxed.

### Banks as "authorised dealers"

Applications can be made to the State Bank of Pakistan that allows banks to deal in foreign exchange. This is subject to the prohibition in section 5 of the Foreign Exchange Regulation Act 1947 and the corresponding general and special exemptions, under sections 3(1) and 3(2) of the Foreign Exchange Regulation Act 1947. The authorisation can allow dealings in all foreign currencies or can be limited to certain foreign currencies. The authorisation can allow all types of foreign currency transactions or be limited to certain types of transactions.

## TAXES AND FEES ON LOANS, GUARANTEES AND SECURITY INTERESTS

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### 27. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

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There is no withholding tax on the granting and enforcement of a loan, guarantee or a security interest. However, the party must pay the court fees for enforcing loan, guarantee or security. Further, payments of interest or profit on deposits by banking companies are subject to withholding tax at rates ranging from 10% to 15%.

Banking companies must pay income tax at a rate of 35% on all income (which includes any interest, yield, profit or fees received by way of loan repayments by borrowers) excluding dividend income and capital gains, which are chargeable at 10% and 12.5% respectively.

### Documentary taxes

The stamp duties for various financial instruments are usually less than a nominal sum (that is, less than INR2000).

### Registration fees

The registration fees for various financial instruments are usually less than a nominal sum (that is, less than INR2000).

### Notaries' fees

Notaries fees are also less than a nominal sum (that is, less than INR2000).

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## 28. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

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Strategies to minimise the costs of taxes and fees are not common, as fees are nominal.

## REFORM

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### 29. Are there any proposals for reform?

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There are no reforms anticipated at this time.



## ONLINE RESOURCES

### State Bank of Pakistan (SBP)

**W** [www.sbp.org.pk](http://www.sbp.org.pk)

**Description.** The website of the SBP provides the key information on the rules and policy guidelines regarding the banking and finance sectors in Pakistan. The SBP itself maintains the website and the information provided is current, up to date, and gathered from the official sources. The website is in English and is for guidance only.

### Securities and Exchange Commission of Pakistan (SECP)

**W** [www.secp.gov.pk](http://www.secp.gov.pk)

**Description.** The website of the SECP provides information on the rules and policy guidelines regarding the corporate and securities sectors in Pakistan. The SECP itself maintains the website and the information provided is current, up to date, and gathered from official sources. The website is in English and is for the guidance only.

### Board of Revenue Punjab (BORP)

**W** <http://lrma.punjab-zameen.gov.pk/laws-rules/laws>

**Description.** The website of the BORP provides information on the rules, policy guidelines regarding land records in Pakistan. The BORP itself maintains the website and the information provided is current, up to date information and gathered from official sources. The website is in English and is for guidance only.

## Practical Law Contributor profiles



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#### Recent transactions

- Acting for World Bank Group (Washington DC, USA) for their Doing Business Project in Pakistan.
- Advised Board of Investment Pakistan on the ease of doing business in Pakistan
- Allied Bank Pakistan for the Enforcement of Collateral against the borrower.
- Advising Johnson Controls Inc. for the Tax Issues in Pakistan.
- Advised Noon Sugar Mills Pakistan for Constituting a Welfare Trust.
- Advised US Denim Mills on the Enforcement of Contract with the local entity.

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