SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
(Securities Market Division)

SECP

GM | DGA | BIC | SES | DGA | IES | DIR
No. 4414
Date: 21-7-10

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July 20, 2010

Mr. Adnan Afridi
Managing Director,
Karachi Stock Exchange (G) Limited,
Stock Exchange Building,
Stock Exchange Road,
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Mr. Muhammad Lukman,
Chief Executive Officer,
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Mr. Imtiaz Haider,
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Mr. Mohammad Hanif Jakhura,
Chief Executive Officer,
Central Depository Company of Pakistan Limited,
CDC House, 99-B, Block B,
S.M.C.H.S., Main Shahra-e-Faisal,
Karachi.

Mr. Ahmed Hasan,
Acting Managing Director,
Lahore Stock Exchange (G) Limited,
19, Khayaban-e-Aiwan-e-Iqbal,
Lahore.

Subject: Report by Committee of Independent Professionals Constituted by the SECP

Dear Sir(s),

As you may be aware, the Karachi Stock Exchange (KSE) earlier in October 2009 had proposed the concept of Margin Trading System to run parallel with the Margin Financing product.

In order to explore additional avenues of liquidity for addressing needs of the market, conduct an overall analysis of the derivative products and to review the KSE's Proposal for Margin Trading, the Securities and Exchange Commission of Pakistan (SECP) on June 22, 2010 constituted a Committee of independent professionals.

The said Committee has submitted its recommendations/ report to the SECP on July 19, 2010 (copy enclosed). You are requested to disseminate the said report on your respective websites and may also table it before your Board of Directors for views/ endorsement.

Yours truly,

Sajjad Ali
Deputy Director (SE)

Cc: Mr. Wasim Baig, Company Secretary, LSE with reference to letter dated July 14, 2010.

Mr. Salman Ali Shaikh
Chairman,
Securities and Exchange Commission of Pakistan
NIC Building, Jinnah Avenue
Islamabad

July 19, 2010

Sub: Report by Committee of Independent Professional Constituted by the SECP

Dear Sir,

On behalf of the Committee of independent professionals constituted by the Securities and Exchange Commission of Pakistan (SECP) on June 22, 2010, I have been advised to submit herewith the recommendations/report of the Committee.

Further, the Committee has requested dissemination of the said report by the SECP to the stock exchanges, Central Depository Company of Pakistan, National Clearing Company of Pakistan Limited along with making it public through the respective websites of these entities.

Yours truly,

Musarat Jabeen
Convener/Coordinator- Independent Committee

Copy : All Members of the Committee

Report by Independent Committee of Professionals Constituted by Securities and Exchange Commission of Pakistan

July 19, 2010

PREFACE

The Securities and Exchange Commission of Pakistan (SECP) during a meeting with the representatives of Karachi Stock Exchange (KSE) Board of Directors, Management and some prominent market participants, on June 22, 2010 constituted a Committee of independent professionals to explore avenues of generating liquidity for addressing the needs of capital markets in the country.

The Committee's mandate entailed a detailed review of the Karachi Stock Exchange's Proposal on 'Margin Trading', an overall analysis of the derivative products currently available at the local bourses and giving recommendations based on international best practices to best suit unique requirements of our local capital markets.

Constitution of the Committee :

Mr. Arif Habib - Chairman, Arif Habib Group	Member
Mr. Dawood Jan Muhammad - Chief Executive Officer, DJM Securities (Private) Limited , Director on KSE Board	Member
*Mr. Shehzad Dada - Chairman, Pakistan Banks Association	Member
Mr. Farhan Malik - Chief Executive Officer, MZNE (Pvt) Limited; SECP nominee Director on the Board of Karachi Stock Exchange (G) Limited	Member
Mr. Shahid Ghaffar -Chief Executive Officer, HBL Asset Management	Member
Mr. Inayat Hussain -Executive Director, Banking Policy and Regulation Group, State Bank of Pakistan	Member
Mr. Adnan Afridi - Managing Director, Karachi Stock Exchange (G) Limited	Member
Mr. Habib-ur-Rehman - Chairman, Mutual Funds Association of Pakistan	Member
Mr. Samir Ahmed - Managing Director, National Commodity Exchange Limited	Member
Ms. Musarat Jabeen - Director, (SM), Securities and Exchange Commission of Pakistan	Convener/ Coordinator

**(Attended first meeting of the Committee. Resigned as CCO of Deutsche Bank Pakistan, his association on the Independent Committee was because of his position as Acting Chairman PBA and association with the Deutsche Bank .*

EXECUTIVE SUMMARY

The Committee greatly appreciates SECP's efforts for addressing liquidity requirements in the local capital markets and the introduction of proposed Securities (Margin Financing, Lending, Borrowing and Pledging) Rules, 2010 ('the proposed Rules'). It apprehends liquidity as one of the essential requirements for a vibrant stock market and the need for launch of financial instruments in line with international best practices.

While giving its recommendations the Committee gave careful consideration towards developing an enabling environment that facilitates introduction of efficient mechanisms for Margin Financing, Securities Lending and Borrowing, Margin Trading, Stock Options and also addresses perceived hindrances limiting the vast potential for healthy activity in the existing derivative market segments available to the Pakistani investors. It is therefore essential that the regulators chalk out a plan for the development of derivative segment and introduce products such as stock options alongside mechanism for securities lending and borrowing, in line with international best practices.

The Committee realized that major modalities of the margin finance and securities lending and borrowing mechanisms have already been worked out to a large extent through earlier consultation sessions while drafting the proposed Rules along with submission of views/comments by stakeholders on the proposed Rules. The Committee therefore focused extensive deliberation on the Margin Trading System (MTS) proposed by the Karachi Stock Exchange (KSE). Utmost efforts were made to mitigate all major aspects of the inherent risks associated with products similar to the proposed MTS, as experienced in the past. Concurrently, efficacy of such products as the MTS which have ingrained features that best-cater to the dynamics of our markets was also assessed.

The Committee while taking full cognizance that MTS being a system based financing product which does not envisage counter-party risk assessment and could therefore pose risk to the market has endeavored its best to fortify MTS with the inclusion of enhanced risk mitigation measures that also better address weak areas identified in the earlier leverage mechanism such as CFS Mk II.

Nevertheless, it is felt imperative that despite a MTS with enhanced risk management measures and increased transparency, the market participants prior to undertaking any activity in the said product ensure that they are well versed with its product features, functional modalities, system requirements and default proceedings, as with other leverage/derivative products. It needs to be underscored that investment in the capital markets, especially through leverage products still pose operational, liquidity and market risks which may result in systemic defaults and such products by no means assure guaranteed returns on investment. Needless to mention that all Financiers in MTS are considered to be sophisticated investors and well aware of the risks associated with this market.

Furthermore, it is viewed that the existing definition of 'net capital balance' for brokers is obsolete and concrete steps need be taken by regulators to establish an appropriate capital adequacy regime in line with international standards.

While recommending the way forward, the Committee is also of the strong view that a comprehensive capital market plan needs to be devised which seeks to set a road map for much longer-term development and sustainable growth of capital markets in the country.

A working paper on 'Margin Trading System' finalized after incorporating views of the Committee Members is enclosed as annexure 'A' and the Committee's review and recommendations in relation to the derivative market is enclosed as annexure 'B'.

ANNEXURE A

WORKING PAPER

MARGIN TRADING SYSTEM (MTS)

1. Eligibility

A. Eligible Financiers

i. All eligible financiers, willing to provide financing through MTS, will acquire status of Authorized Financier (AF), which status will be granted by NCCPL in accordance with the criteria laid down for this purpose. There will be two categories of AFs:

1. Non Broker AFs (NBAF)
2. Broker AFs (BAF)

ii. An agreement between NCCPL and AFs shall be executed for the settlement of MTS transactions.

iii. AF premises will be outfitted with NCCPL's automated terminal, through which finance offers may be made on real time basis. Through these terminals AFs can offer finance at given rates for specified scrips, withdraw such offers, and/ or change the rate of finance offered till such time that the offer is accepted. Once accepted the offer becomes irrevocable and the contract becomes firm.

iv. Following are the potential Authorised Financiers:

- a banking company within the meaning of the Banking Companies Ordinance, 1962 (LVII of 1962).
- a company, corporation or institution to which Section 3A of the Banking Companies Ordinance, 1962 (LVII of 1962).
- A Non Banking Finance Company (NBFC)
- an investment company and a closed-end scheme, registered with the Commission under the NBFC Rules, and permitted such financing in this product,
- an open-ended scheme of any kind constituted under the NBFC Rules, and permitted such financing in this product
- a member of stock exchange registered with SECP as a broker. (A client of a broker may also provide financing through such broker, however; minimum requirement for financing amount from such client shall be Rs. 5 million).

- Any other person as may be approved by the NCCPL (BOD), with the approval of SECP, such as pension funds, EOBI etc.

B. Eligible– Broker Financee

i. Brokers of Karachi, Lahore & Islamabad stock exchanges will be the only takers of finance from MTS market by using their NCCPL terminals.

ii. Broker Financees will have access to finance for and on behalf of their clients and for their own accounts. All acceptances of offers of finance shall be executed by inserting unique client codes, which are registered on the UIN system, for their client as well as for the proprietary trades.

iii. MTS will conduct pre-verification that each eligible Broker Financee has already a long ready market position on that day on a particular UIN before it allows MTS transaction to take place and ensures that no financing is allowed against shares already held in his portfolio. Such long position will be exclusively marked in the trading system through a separate function key, whereby MTS shall allow financing on trades executed through this special key assigned. In order to restrict financing against house shares, system shall compare the UIN level net purchase position at the end of trading with the finance availed in MTS market and any excess financing shall be force released on the same day. The only exception would be where the MTS contract is being refinanced due to force release on maturity of date of earlier MTS contract.

iv. Where financing could not be availed from MTS market on the trades executed through aforementioned separate function key, such trades shall be settled along with other ready market trades as per normal settlement mechanism.

v. Broker Financee shall be required to maintain client level margins as per Client Level Margining Regime presently being followed at the stock exchanges. Broker Financee will be required to collect all margins and Mark-to-Market (MTM) losses from respective client/UINs in respect of MTS transactions.

C. Eligible– Securities

Following will be the eligibility criteria for MTS:

i. Companies that during the review period have an average daily Impact Cost of less than 1% based on daily impact cost on an order size of Rs.500,000

ii. Companies that have traded on more than 90% of the trading days during the review period.

iii. Companies that have average daily turnover of more than 1,000,000 shares during the review period.

iv. Companies that have Free Float of more than 35% of issued capital or 60 million Free Float shares.

v. Securities of Listed Asset Management Companies, Mutual Funds, Brokerage Houses and companies whose principal activity includes short term investment/trading in securities shall not be eligible. A Broker Financee can not avail financing in any scrip where he is a Director or sponsor or such scrip is an Associated Company or Associated undertaking of such Financee. AF shall not provide financing in scrip where such AF is a Director or Sponsor or such scrip is an Associated Company or Associated undertaking of such AF.

vi. Companies that do not have negative/qualified opinion related to the Going Concern in Auditor's report on the Company's Financial Statements (Last Report)

vii. Companies that are not subject to any investigation/ enquiry by any regulatory body which leads towards suspension.

viii. Companies not on the defaulters segment

ix. Criteria No.i, ii, iii, and iv mentioned above are subject to monthly review and any scrip which does not meet any of these criteria shall be excluded from the list of Eligible Securities after giving notice of one month.

x. Free float of the company must be in dematerialized form on CDS.

2. Key Features

i. The MTS shall be a separate and exclusive market. However, settlement of MTS market transactions shall be linked and netted-off with the Ready market in such a manner that settlement obligation shall be shifted from or to AF and Financee, as the case may be. Whereas, in case of default, the treatment and management of default shall be managed in a completely distinct manner whereby default of MTS market and Ready Market will not be intermingled.

ii. MTS will ensure, through pre-trade verification, that all client codes used in the MTS Market i.e. all AFs and financees, are registered on the UIN data base.

iii. All transactions executed in MTS market will be based on Financing Participation Ratio i.e. FPR%. For this purpose, FPR will be higher of VaR estimate or 25% for the Financee. Accordingly, on settlement date of first leg transaction Broker Financee shall be required to pay such FPR and AF to pay rest of the amount of the contract price.

iv. Such FPR% shall be maintained at all time after the settlement of first leg transaction through MTM adjustments i.e. MTM will be collected from Broker Financee as per the AF's FPR% and paid to respective AF so as to align the contract value.

Example: If original contract price was Rs. 100 with FPR of 75 and 25 respectively. In case price of particular security goes down by Rs. 5 by the end of settlement day i.e. T+2, the MTM from Broker Financee shall be collected by Rs. 3.75 and paid to the respective AF accordingly. FPR will now become adjusted to 71.25 and 23.75 respectively. Similarly, the rate of return shall also be calculated at Rs. 71.25 and so on. However, no treatment shall be applied in case of MTM profits.

v. AFs shall input offers of finance on MTS market in the form of number of specified shares required to be financed together with required rate of return.

vi. Rate of return will be determined as the rate which adequately prices risk inherent in the share and shall be determined exclusively by each AF. However, such rate of return should not be greater than one-month KIBOR+8%. All offers and bids will be transparently displayed on MTS.

vii. Financees will have access to all unmatched offers available on each share and will accept AFs' offers directly through MTS terminals. On matching bids and offers, contract will be confirmed and become irrevocable. Financees will be able to place their own bid for acquiring financing which any AF may accept for financing in a transparent and open manner.

viii. The trading will be done on an undisclosed basis in MTS Market.

ix. Each new MTS contract will be for maximum 60 calendar days. Broker Financee may release availed funds at any time during tenure of the contract i.e. within 60 calendar days, on selling his position in ready market or wanting to take delivery. Broker Financee shall be allowed to release the contract on same day of its execution. However, same day release will cause a one day charge of funds on the value of financed shares, to be paid to the AF by the financee. In case of holidays i.e. weekly and gazette the compulsory release date will be adjusted accordingly.

x. The MTS contract period shall be limited to 60 calendar days which will be subjected to compulsory release by NCCPL at 1/4th of the original quantity of the contract i.e. at every 15th calendar day. In case of holidays i.e. weekly and gazette such compulsory release on every calendar day will be adjusted accordingly.

xi. In case Broker Financee releases his open position before the force release by NCCPL, such released shares shall not be available for fresh financing in MTS market.

xii. Broker Financee may before the expiry of the original contract i.e. before completion of 60 calendar days, (except compulsory release by NCCPL) partially or totally release the contract to enable him to settle his sales position in the Ready Market.

xiii. Settlement of MTS contracts will be on T+2 basis.

xiv. Necessary reports shall be made public on a timely and routine basis for the satisfaction of the market participants. These statistics may inter-alia include the following:

a) Top 15 AFs and financees in MTS market will be disclosed by name.
b) Number of financiers in the MTS market will be disclosed together with the total amount of financing provided for all MTS eligible shares.
c) Total disbursements in the market and per eligible scrip;
d) Total funds due to be released in next 3 days on expiry at every15th calendar day which may be refinanced.
e) Total amount of MTS released in the day.
f) Total amount of MTS released for each MTS eligible share.
g) Total funding provided in each share. Percentage of MTS funds invested in each of the eligible shares.
h) Total amount of MTS funds released during the day and refinanced.
i) Weighted average rate of interest charged in each of the eligible scrips for the day.
j) Total amount availed by the financees and the number of financees in the market place.

3. Capital Adequacy

Broker Authorised Financier

i. Minimum net capital balance for Broker Authorised Financier shall be Rs.10 million.

For Broker Financee

ii. Minimum net capital balance for Broker Financee shall be Rs. 10 million.

iii. Every Broker Financee shall not exceed its leverage position in respect of MTS market by 5 times of Net Capital Balance allocated for MTS market.

4. Position Limits for Broker Financee:

i. In order to check undue concentration in a particular security and to prevent cornering/manipulation, scrip-wise position limit should be imposed in the MTS market as follows:

Market wide position limit in MTS Market:	20% of free-float for each scrip subject to maximum of Rs. 10/ 8 billion.
Member wide position limit in MTS Market:	2% of free-float of the scrip subject to maximum of Rs. 1 billion.
Client wide position limit in MTS Market:	0.5% of free-float of the scrip. Client position will be universal and determined on UIN basis subject to maximum of Rs. 250 million for each scrip. Provided that overall financing availed in all eligible scrips shall not exceed Rs.1.25 billion.

Net capital balance limit in MTS Market :	5 times of the NCB of broker financee or Rs.5 billion whichever is lower.
Maximum exposure in all Leverage Markets (MTS, Cash Settled Futures, Stock Index Futures, and Deliverable Futures Contract Market)	7.5 times of the NCB of broker

5. Authorized Financier's Risk Management

i. All AFs shall deposit exposure margins and pay MTM losses to stock exchange and NCCPL in the form of acceptable collaterals from the date of execution of transaction on T date till settlement to cover the settlement risk.

ii. All such margins will be held exclusively by NCCPL, segregated from Ready and other markets' margins, for the benefit of MTS market participants, primarily the AFs.

iii. On settlement of first leg of transaction, AF shall not be required to place any margins or MTM losses with the NCCPL provided that the financed shares are held in AFs name (for proprietary trade) or the client Financier name, in a separate CDC blocked account opened for the purpose of settlement of MTS transactions through NCSS. All other activities i.e. inter account movement; pledge etc. shall be prohibited through such CDC blocked account.

AF shall have an option to pledge his proprietary MTS financed shares (lying in a CDC blocked account) for the purposes of pledge against exposure with the stock exchanges and NCCPL till affirmation of the same. These shares are only supposed to be pledged against the IDS trades till their affirmation, however, since the institutional exposure cannot be calculated separately, these shares will be valued at 50% of their value and subject to applicable haircuts and acceptable against total exposure of the broker. These pledged shares shall be released/ not valued as exposure margins upon affirmation of trades by institutional clients through IDS. In such case the open second ticket sell position of AF upto the extent of pledged shares to stock exchange and NCCPL, shall be included in his exposure calculations for capital adequacy purposes. Accordingly, necessary exposure margins and MTM losses shall be collected from such AFs.

iv. However, such blocked shares cannot be pledged against MTM losses of any broker and non-broker AF;

v. Upon settlement on T+2, the MTS financed shares shall automatically be transferred to a separate CDC blocked account in the name of the AF or its financier client and the margins held against MTS financing for the first 2 days shall be released.

6. Broker Financee's Risk Management

i. Broker Financee shall pay **exposure margins, MTM losses** and **liquidity margins** in the form of acceptable collaterals from the date of transaction till date of settlement of first leg of transaction. However, exposure margins shall be higher of 25% or VaR estimate of that particular security along with concentration margin in the form of cash/ security till the settlement of first leg of transaction.

ii. Thereafter, MTM losses and concentration margins *(for concentration margin please refer Annexure I)* shall be collected in CASH only till settlement of second leg of transaction.

iii. Concentration margins will be held by stock exchanges and NCCPL and thus will remain segregated from all other markets' margins held by stock exchanges and NCCPL. After settlement of first leg (Ready Market) MTS related margins will be utilized for the benefit of AFs only on default of the Broker Financee or vice versa.

iv. MTM losses will be collected from Broker Financee as per the AF's FPR% and will be paid to respective AF's so as to align the contract value.

7. Corporate Action in MT Blocked Shares

- Handling of corporate action in MTS market shall be the same as was applicable in CFS MK-II market *(enclosed as Annexure II)*

8. Default Management

- **In case of AF Default:**

  i. In case AF does not deposit margin call within the stipulated time; or does not make the required payment by the stipulated time on settlement date, a default will be triggered and NCCPL shall initiate following proceedings:

    1) NCCPL shall hold credit of all market participants till the recovery of shortfall amount. However the losses shall be allocated only to the AFs in the MTS Market.
    2) All margins of AF held by NCCPL shall be liquidated;
    3) Settlement obligation of such defaulted AF will be shifted to the respective Financees who would be given the opportunity to obtain re-financing from another AF
    4) However, shares already held in CDC blocked account of such defaulted AF will be released on their respective maturity dates.

- **In case of Broker Financee Default**

A. Failure to pay MTM Loss to Maintain its FPR% i.e. 25% or VaR estimate whichever is higher

- **In case where Broker Financee fails to deposit a MTM loss within the stipulated time following action will be taken by NCCPL:**

I. In case where certain number of UINs of Broker Financee is in default however Broker Financee has fulfilled requisite MTM call through his own resources no action shall be initiated against such Broker Financee. However, Broker Financee shall be required to identify the defaulted UINs.

II. In case where certain number of UINs of Broker Financee is in default and Broker Financee has also failed to deposit the requisite MTM call following procedure will be applied:

i. Broker Financee shall be required to identify the defaulted UIN;
ii. NCCPL shall immediately suspend such UIN to take further position in any market.
iii. NCCPL shall issue notice at the day end to such relevant Broker Financee to square up the open position of such UIN within 3 hours of opening of market next trading day and deposit the requisite MTM Loss amount. In case the Broker Financee is not able to sell the shares, NCCPL will try to liquidate the same.
iv. At the end of day (second day of default), open position of such UIN shall be released and handed over to respective AF along with respective collaterals deposited with the stock exchange and NCCPL and related open position shall be treated as closed accordingly.
v. Afterwards, such defaulted UIN and relevant Broker Financee shall be penalized in the following manner:

   - such UIN shall be restricted from taking new positions in all markets and will only be able to reduce his open position and after necessary Arbitration process, if found non-compliant shall be suspended for a period of 6-months .
   - Relevant Broker Financee shall be charged by 2% of the defaulted amount of such UIN's open position.
   - Such charge of 2% shall be contributed towards MTS protection fund.

vi. In case of second default of similar UIN, it will be blocked for a period of three years.

B. Settlement Default by Broker Financee

I. In case where Broker Financee defaults in meeting money settlement obligation, pertaining to MTS Market and other market, following procedures will be applied:

i. NCCPL shall suspend such Broker Financee in MTS Market and all other Markets as well;

ii. Accordingly, NCCPL shall hold proportionate credit of all Market participants till recovery of shortfall amount/finalization of default.

iii. NCCPL shall segregate the defaulted amount market-wise.

iv. All margins of Broker Financee held by NCCPL and stock exchange shall be liquidated in a segregated manner market wise;

v. NCCPL shall initiate square-up process of market-wise all open position of such defaulted Broker Financee for two working days. However, NCCPL will try to square up the open position in the MTS within one day

vi. In case of successful square-up, proceeds shall be applied to compensate the corresponding AFs and other market participants.

vii. In case of partial or no square-up of market wise position, NCCPL shall apply the following:

- **In case of MTS Market**-respective shares will be handed over to the corresponding AFs with related unutilized margins. In such case 2% penalty of the defaulted MTS open position shall be charged to Broker Financee.

- **In case of shortfall pertaining to other market transactions**- normal default proceedings shall be applied on such defaulted Broker Financee to cover the shortfall amount.

9. MTS Market Protection Fund

- Certain portion of transaction levy shall be allocated towards such Fund.
- MTS Market Protection Fund shall exclusively be utilized for the satisfaction of losses of MTS market.

Annexure B

A Review of the Derivative Sector

The Committee reviewed in detail presentation prepared by the KSE on the derivative segment which encompassed salient features of each derivative product currently available at the bourses i.e Cash Settled Futures Contract, Deliverable Futures Contract, and Stock Index Futures.

It is principally agreed that in order to ensure growth of our capital market in the long run, development of the derivative sector in line with international best practices is imperative. In most jurisdictions developed derivative segments contribute to a major portion of overall turnover at the stock exchanges.

The failure of Cash Settled Futures (CSF) in our market despite the availability of different contract periods and a risk management regime with relatively less margins when compared to the deliverable futures product is disappointing. The Committee also noted the impact of substitute derivative products in the cash segment and the Deliverable Futures Contracts on the success of internationally accepted and successful derivative products based on cash settlement. Therefore, in order to promote the CSF market, the market participants, particularly the sellers need to be provided with appropriate tools for hedging their positions. The most suitable choice for this purpose is the Securities Lending and Borrowing (SLB) mechanism and introduction of Options. Although, significant progress has already been made on the development of SLB product which is in the final stages in terms of regulatory framework, the Committee strongly recommends the early introduction of options.

It goes without saying that participation from financial institutions is one of the crucial components for the success of CSF product and market making is an essential requirement for the product to gain market acceptability. In view of the same, the active role of prominent brokers to generate liquidity in this market can not be overemphasized. Yet another factor impacting the segment is the lack of awareness amongst market constituents which needs to be addressed through initiation of awareness drive among market participant and general investors.

Furthermore, it is noted that as per the current regulatory framework, which has been designed keeping in view the delivery based derivative products; mutual funds are not allowed to un-hedge their positions in the CSF market. It is therefore recommended that suitable amendments are incorporated in the legal framework to remove this anomaly.

In relation to the risk management regime for Deliverable Futures Market (DFM) the margining regime seems to be quite satisfactory as it is less stringent when compared to the proposed MTS product. The Committee is cognizant of the fact that performance of the derivative segment is also linked with the activity in the Ready Market and hopes that subsequent to the introduction of Margin Financing, MTS and availability of securities lending and borrowing mechanism, the performance in DFM will be further improved.

Processing of Corporate Actions Pertaining to CFS Financed Securities

7.1 Purpose and Scope

Under the CFS transactions the financier is not the beneficial owner of the securities instead the securities are held as Collateral against the financing provided to the beneficial owner of the securities (financee).

Any entitlements on such shares arising due to corporate action should accrue to the beneficial owner of the securities (financee) and not to the financier. Pursuant to recent commandments in CFS regulations promulgated by Karachi Stock Exchange (KSE), the CFS transactions are no longer allowed to be forced released before the Book Closure (BC) Date. CFS Financed securities are held by the financier in their CFS Blocked Account maintained with Central Depository Company (CDC). The entitlements on all such shares are received by the financier and later on they are transferred to the financee manually through Stock Exchanges. This practice required cumbersome manual work and resulted in creating risk in the recovery of the entitlements from the financier to the financee

Due to the mentioned reason an automatic mechanism is being introduced whereby entitlements shall be directly delivered to the respective rightful beneficiary(ies).

7.2 Application of the Mechanism

The mechanism shall be applicable to the following entitlements:

- General Meetings
- Cash Dividend
- Stock Dividend
- Rights

The mechanism shall not be applicable for the following corporate actions:

- Mergers
- De-mergers
- Split
- Consolidation, etc.

For such corporate actions, CFS trades shall be required to be forced released before the start of BC period.

7.3 Assigned Responsibilities

7.3.1 Stock Exchange (SE)

It shall be the responsibility of Stock Exchange to ensure that all the CFS trades remain locked from SPOT trading date till the Book Closure (BC) Date. During the aforementioned period, CFS release or open market CFS session shall not be allowed for securities traded on SPOT basis.

Exchange shall ensure to provide the trade data to the Company, based on the Company's UIN database which has been provided to Exchange by the Company on daily basis.

7.3.2 National Clearing Company (NCC)

The Company shall be responsible to provide CDC with the data comprising of the financier and financee UIN related information along with the security and volume of shares involved in the CFS transactions. Information related to the financiers and financees shall be provided by the Company to CDC atleast one business day prior to the commencement of BC period:

- CM ID
- UIN (Both for Financier and Financee)
- UIN Type (Both for Financier and Financee)
- Security Symbol
- Stock Exchange Location
- Volume

7.3.3 Central Depository Company (CDC)

CDCPL shall be responsible for further transfer of CFS Financed Securities from the financier to the financee on the basis aforementioned information provided by the Company through an agreed upload mechanism under these procedures.

7.3.4 Clearing Members (CM)

It shall be mandatory for CFS financee to open and maintain CDS House / Sub Account (as applicable), in order to avail the financing facility from CFS Market. It shall be the responsibility of the Clearing Member (CM) to use correct UIN while executing proprietary trades, inter exchange trades and trades on behalf of clients and also ensure that the CFS Financee shall use same UIN in NCSS UIN database as well in CDS House / Sub-Account.

In case of automated handling of Corporate action of CFS Financed Securities, the Inter-Exchange trade information shall be processed based on the UIN of the initiating CM instead of client(s) of such initiating CM.

7.4 Upload Mechanism

User generates the required file containing the UIN information of (financier and financees) to be uploaded to CDS through an available interface provided by the CDC. In case an error is found by CDS in the Uploaded file, CDS shall provide a downloadable file (Error Report) that shall contain the details of the errors found. Such erroneous record(s) shall be processed manually where applicable.

On the basis of such uploaded file, CDC executes automatic movement of securities in accordance with their Regulations and Procedures.

7.5 CFS Open Position Report

Clearing Members may view the information related to buy and sell position of Exchange and Non-Exchange Transactions, Net BO obligation, Net Open Position (After Settlement) and Open CFS Position through CFS Open Position Report.

7.6 Exceptions

The automatic transfer shall not be executed if:

- UIN of Financer or Financee mismatches with CDS Account details.
- Shares are pledged from a Financer's account.

- There is any restriction for the movement of securities on either side (Financee or Financer) by any Regulatory authority.
- Shares are parked in Main account instead of respective account such as Sub Account or House Account of Financer.

In all such cases entitlement shall be issued / credited into financier account.