



PAKISTAN STOCK BROKERS ASSOCIATION

(A company setup under section 42 of the Companies Act 2017)

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NOTICE FOR MEMBERS

REVIVAL PLAN CASH SETTLED FUTURES (CSF) CONTRACTS

Respected Members,

We would like to bring to your attention the presentation on the Cash Settled Futures Contract revival plan that has been shared by the Pakistan Stock Exchange. This plan aims to revamp the CSF stock eligibility criteria, risk management regime, corporate action process, final settlement price, etc.

We encourage all members to review the presentation and provide any feedback and suggestions you may have. Your input is vital in shaping the success of this revival plan.

We appreciate your attention to this matter and look forward to your valuable input.

Thank you for your cooperation.

sd
AKBER ALI
Officer - Secretariat

Encl: CSF Presentation

Copy to: PSBA Website

Revival Plan



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Cash Settled Futures (CSF) Contracts

By PSX to PSBA

Jul 07, 2023

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Background

- Cash Settled Futures (CSF) were launched in 2007 (*post 2005 crisis as it carries lower settlement risk*) and SIFC in 2008
- DFC was discontinued for a period of six months in 2009 (*post 2008/2009 crisis*), however, CSF was actively listed during that period of time with *all DFC scrips were made available*
- SECP constituted Derivative Market Review Committee (2016) and made [suggestions](#) to revive the product, some of the changes of that committee are already implemented, still no interest
- Amid New Trading System (NTS) launch, PSX temporarily suspended the CSF market (Oct 2021) and proposed a refined product in the light of feedback received from brokers in multiple sessions to make another attempt to revive the product

Dedicated Sessions with Stakeholders

- To seek the market feedback and re-design the product, two dedicated sessions were held with brokers, NCCPL and SECP (*June 2021 and November 2021*).
- The key suggestions received were predominantly related to:
 - I. Stock eligibility criteria
 - II. Futures final settlement price to be aligned with Ready price
 - III. Revamping of the risk management procedures commensurate with the lower settlement risk in CSF
 - IV. SIFC to be considered later after CSF is activated – practical issues are same

DFC vs CSF



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Deliverable Future Contracts (DFCs)	Cash Settled Future (CSF) Contracts
Physical delivery of underlying asset	Net Cash settlement
Higher level of settlement risk but low speculation risk	Low settlement risk but higher speculation risk – need to keep margins up to date
Hedging flexibility	Flexible and less complex
Buy Ready sell Future	Price converge with spot price
Low basis risk	Cost effective

Proposed CSF Eligibility Criteria

- Top three liquid stocks from DFC eligible list (*quarterly basis*)
- Stocks excluded from DFC based on only FF criteria (*quarterly basis*)
- Outgoing stocks of DFC shall be made eligible in CSF (*quarterly basis*)
- All IPOs are eligible for inclusion in CSF for three month (*monthly basis*), after which it will be considered based on liquidity tests. Will Continue to be added on monthly basis till first quarterly DFC implementation (when at least traded for 6 months)
- Based on previous 30 trading days data, DFC nearing UIN/Broker position limits[^] are identified using market wide data as a proxy i.e., DFC with market wide limit utilization of 15% for 7 or more trading days shall be added to CSF eligible universe with opening of immediate CSF contracts (*monthly basis*)
- *Estimated Universe around 12 to 15 [no upper cap proposed]*

[^] Data to be provided by NCCPL on monthly basis

List of CSF Eligible Stocks – CSF Criteria

No.	Symbol	Name	Percentile Rank	Reasons for Inclusion
1	ENGRO	Engro Corporation Limited	0.00%	Top 3 DFC Liquid Stocks
2	SYS	Systems Limited	0.30%	Top 3 DFC Liquid Stocks
3	FFC	Fauji Fertilizer Company Limited	0.50%	Top 3 DFC Liquid Stocks
4	ABOT	Abbott Laboratories (Pakistan) Limited	10.50%	DFC Liquidity Eligible But FF Fail
5	HCAR	Honda Atlas Cars (Pakistan) Limited	22.30%	DFC Liquidity Eligible But FF Fail
6	INDU	Indus Motor Company Limited	8.40%	DFC Liquidity Eligible But FF Fail
7	LCI	Lucky Core Industries Limited	13.50%	DFC Liquidity Eligible But FF Fail
8	MARI	Mari Petroleum Company Limited	3.30%	DFC Liquidity Eligible But FF Fail
9	OCTOPUS	Octopus Digital Limited	34.10%	DFC Liquidity Eligible But FF Fail
10	FATIMA	Fatima Fertilizer Company Limited	10.00%	DFC Outgoing
11	SNBL	Soneri Bank Limited	24.40%	DFC Outgoing
12	TPLP	TPL Properties Limited	9.10%	MW Position Limit hit 15% utilization for more than 7 Trading Days
13	TRG	TRG Pakistan Limited	1.20%	MW Position Limit hit 15% utilization for more than 7 Trading Days
14	UNITY	Unity Foods Limited	7.50%	MW Position Limit hit 15% utilization for more than 7 Trading Days
15	PRL	Pakistan Refinery Limited	9.80%	MW Position Limit hit 15% utilization for more than 7 Trading Days
16	FFL	Fauji Foods Limited	18.60%	MW Position Limit hit 15% utilization for more than 7 Trading Days
17	CENERGY	Cnergyico PK Limited	5.80%	MW Position Limit hit 15% utilization for more than 7 Trading Days
18	KEL	K-Electric Limited	6.10%	MW Position Limit hit 15% utilization for more than 7 Trading Days
19	WTL	Worldcall Telecom Limited	3.50%	MW Position Limit hit 15% utilization for more than 7 Trading Days
20	GRR	Globe Residency Reit	48.70%	IPO Previous six months

Settlement Price – Int’l Exchanges

	NSE/BSE India	KRX	SET (Thailand)	TAIFEX (Taiwan)	BME (Spanish)	HKEX (Hong Kong)	Dubai Financial Market	PSX
Final Settlement Price Rule	The closing value of the underlying is the final settlement price.	Closing price of the underlying stock on the last trading day	The volume weighted average value of the underlying share trading transaction during last 15 minutes and at the closing on the last trading day, rounded to the nearest two decimal points.	The final settlement price for a single stock futures or equity option contract shall be determined by the arithmetic mean of the prices of the underlying security on the securities market during the last 60 minutes of trading before market close on the final settlement day.	The Closing Price of the stock on the Date of Expiration.	Final Settlement Price (FSP) shall be revised to the official closing price of the underlying stock as quoted by SEHK on the Last Trading Day.	Underlying Security Close Price	Average bid/ask quote of the Security in the Ready Delivery Contract Market which would be calculated as a ratio of A/B where “A” equals the sum of market bid and ask prices taking the best bid and best ask price of the Security during each one minute interval for last two hour trading on the last trading day of the Contract or where no trading takes place on that day, the immediate preceding trading day. “B” equals the total number of bid and ask prices sampled i.e. 240.

- Firstly, the difference at PSX is the use of BIDs and OFFERS (*designed to address price manipulation on settlement date especially for illiquid stocks*)
- For a liquid stock, it is unfair for a trader to settle a CSF trade at a different price than the price of the underlying
- Risk Mitigated by including only liquid scrips in CSF (though IPO may carry risk)
- PSX practice not in line with international exchanges with CSF product
- **Proposed to keep the closing price of underlying security in the Ready market on the last trading day as ‘Final Settlement Price’**

Corporate Adjustment

Deliverable Stock Futures (DFC)	Cash Settled Stock Futures (CSF)	Recommendation for CSF
In case of Right/Bonus Issue and Cash dividend, Contracts are broken down into A / B and rollover week is provided	<p>In case of Right/Bonus issues, Contract Multiplier & contract price are adjusted.</p> <p>There is no need to break the contract into A B due to Bonus and Right Issue by pre-dating the maturity of contract</p> <p>This practice will try to keep the exposure the same at pre and post corporate action exercise in the underlying</p>	Cash Dividends will also be included in the adjustment method of CSF.

Example # 1 (Bonus Issue)

Example of Bonus Issue in the underlying share and its adjustment in CSF contract to keep the exposure consistent

For instance, if an underlying Ready market stock such as ODGC which is trading at Rs. 140.00 (while CSF futures was at Rs. 143.00 and per contract position is $500 \times 143 = 71,500$) experiences a bonus issue of 15%. Its ex-price in the Ready market becomes Rs. 121.74.

Ratio for Adjustment in CSF = Ex-Price (Ready) / Cum Price (Ready) = $121.74 / 140.00 = 0.8695714286$

Contract Multiplier = $500 \text{ shares} / 0.8695714286 = 575$

Ex-Future Price = $143.00 \times 0.8695714286 = 124.34$

Total Position (Exposure) = 71,501

Note: Any rounding difference will be re-distributed in the price to bring ex-price and cum price based exposure consistent.

Example # 2 (Right Issue)

Example of Right Issue in the underlying share and its adjustment in CSF contract to keep the exposure consistent

For instance, if an underlying Ready market stock such as ODGC which is trading at Rs. 140.00 (while CSF futures was at Rs. 143.00 and per contract position is $500 \times 143 = 71,500$) experiences a Right Issue of 15% additional shares for each share held at a discount of Rs. 100.00.

Its ex-price in the Ready market becomes Rs. 134.78.

Ratio for Adjustment in CSF = Ex-Price (Ready) / Cum Price (Ready) = $134.78 / 140.00 = 0.9627142857$

Contract Multiplier = $500 \text{ shares} / 0.9627142857 = 519$

Ex-Future Price = $143.00 \times 0.9627142857 = 137.67$

Total Position (Exposure) = 71,450

Note: The rounding difference will be redistributed in the price to bring exposure near 71,500. ($\text{Rs } 50 / 519 = \text{Rs. } 0.10$ per share - - - - - Ex-Future price = $137.67 + 0.10 = 137.77$ - - - - - > Exposure = $519 \times 137.77 = 71,502$)

Example # 3 (Cash Dividend)

Example of Cash Dividend in the underlying share and its adjustment in CSF contract to keep the exposure consistent

For instance, if an underlying Ready market stock such as ODGC which is trading at Rs. 140.00 (while CSF futures was at Rs. 143.00 and per contract position is $500 \times 143 = 71,500$) experiences a cash dividend of Rs. 8 per share.. Its ex-price in the Ready market becomes Rs. 132.00.

Ratio for Adjustment in CSF = Ex-Price (Ready) / Cum Price (Ready) = $132.00 / 140.00 = 0.9428571429$

Contract Multiplier = $500 \text{ shares} / 0.9428571429 = 530$

Ex-Future Price = $143.00 \times 0.9428571429 = 134.83$

Total Position (Exposure) = 71,460

Note: The rounding difference will be redistributed in the price to bring exposure near 71,500. ($\text{Rs } 40 / 530 = \text{Rs. } 0.07$ per share - - - - - Ex-Future price = $134.83 + 0.07 = 134.9$ - - - - - > Exposure = $530 \times 134.83 = 71,497$)

NCCPL's Proposed RM Framework

No	Parameter	Deliverable Futures Contracts (DFC)	Cash Settled Futures Contracts (CSF)	Stock Index Futures Contracts (SIFC)
1	Basic Deposit	Rs. 1 million in cash per broker for all of the three above-mentioned markets. In addition, this deposit can be utilized against exposure margin requirement for these markets. <i>{Earlier the basic deposit requirement was not applicable to CSF and SIFC}</i>		
2	Components of Exposure Margin %age <i>{No Change}</i>	<ul style="list-style-type: none"> - Raw VAR - Scale up Raw VAR (Using DFC Scale up Factor) - Worst Case Margin 	<ul style="list-style-type: none"> - Raw VAR - Scale up Raw VAR (Using READY Scale up Factor) 	<ul style="list-style-type: none"> - Raw VAR - Worst Case Margin
3	Form of Exposure Margin Deposit	<ul style="list-style-type: none"> - Min 50% Cash, Near Cash and BG - Remaining in DFC eligible securities, Cash, Near Cash and BG 	<ul style="list-style-type: none"> - Any form / combination of Market Collateral <i>{Earlier it was min 50% in Cash/BG}</i>	<ul style="list-style-type: none"> - Any form / combination of Market Collateral <i>{Earlier it was min 50% in Cash/BG}</i>
4	Netting Across Contracts for Exposure Margin <i>{No Change}</i>	Higher of Contract Wise Net Buys and Net Sells (calendar Spread in same underlying)	Higher of Contract Wise Net Buys and Net Sells (Calendar Spread in same underlying)	No Benefit in Calendar Spread (same underlying) Transaction
5	Marked to Market Loss <i>{No Change}</i>	Cash	Cash	Cash
6	Marked to Market Profit Credit / Distribution <i>{No Change}</i>	Distribute Certain %age of Profit	Distribute 100% of Daily Profit	Distribute 100% of Daily Profit

NCCPL's Proposed RM Framework cont'd

No	Parameter	Deliverable Futures Contracts (DFC)	Cash Settled Futures Contracts (CSF)	Stock Index Futures Contracts (SIFC)
7	Concentration Margin	Applicable based on Contract Position and FF and collected in the form of Cash/Near Cash/BG	Waived for One Year but will be collected in the form of Market Collateral <i>{Earlier it was same as mention for DFC}</i>	Not Applicable
8	Special Margin	Not Applicable	Not Applicable	Market Collateral <i>{Earlier required in Cash/BG}</i>
9	Additional Margin	<ul style="list-style-type: none"> - Min 50% Cash/Near Cash/BG - Remaining in DFC Eligible Securities, Cash, Near Cash and BG 	Market Collateral <i>{Earlier it was min 50% in Cash/BG}</i>	<ul style="list-style-type: none"> - Market Collateral <i>{Earlier it was 100% in Cash/BG}</i>
10	Position Limits	<p>Stock Category Based, For Instance A Cat. Stock have: Market Wide-50% & B Cat. Stock Market Wide 40%</p> <p>Broker Wide-10% of MW UIN Wide-5% of MW</p>	<p>Irrespective of Any Category: Market Wide-100% Broker Wide-10% UIN Wide-5% <i>{Earlier MW limit was 40%}</i></p>	<p>No Market Wide</p> <p>Broker Wide- Higher of 10% of total interest or 10,000 Contracts</p> <p>UIN Wide-Higher of 1% of total interest or 1,000 Contracts</p>
11	Netting across Contracts for Position limits <i>{No Change}</i>	No Netting among same stock with different maturity	No Netting among same stock with different maturity	No Netting among same index but different maturity
12	Close-Out Procedures	Applicable	Introduced same as in DFC <i>{Earlier there was no procedures}</i>	Introduced same as in DFC <i>{Earlier there was no procedures}</i>

Miscellaneous

- Trading fee may be incentivized
- Contacted FBR for a favorable CGT rate for CSF, will continue to seek CGT rate at 5%
- Awareness sessions with brokers and public
- Market making may also be considered at a later stage
- Brokers should consider providing CSF to ensure all clients (based on their initial risk assessment) i.e., customer self-trading in CSF through online applications

Project Plan

→ Things to be Done:

- Regulatory Amendment in PSX and NCCPL Rules. For PSX, the process will be initiated once system wise discussion is concluded with SZSE
- System Development and Testing
- Website Modification
- Procedural Arrangement between NCCPL and PSX
- Brokers OMS, systems development
- Testing
- Awareness Sessions



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Thank You