



PAKISTAN STOCK BROKERS' ASSOCIATION

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

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August 18, 2020

MR. FARRUKH KHAN

Chief Executive Officer

Pakistan Stock Exchange Ltd

Karachi.

Subject: **CLIENT'S ASSETS UNDER BROKER'S CUSTODY**

Dear Sir,

This is with reference to the subject matter and our various meetings on many issues with the Apex Regulator, Securities and Exchange Commission of Pakistan (SECP) and the front line regulator, Pakistan Stock Exchange (PSX). It has been observed that all efforts to put in Rules, Regulations, and Laws are concentrated and aimed towards mitigating the risk of Client's assets under the broker's custody.

All these efforts are in accordance with the preamble of the Securities Act 2015, which clearly states **Protection of Investors** amongst the main objectives of Securities Act, 2015.

There are basically following two types of Client's assets under broker's custody:

1. Securities; and
2. Cash balances.

CUSTODY OF SECURITIES

Different sets of Rules, Regulations, and Laws enacted to mitigate custody risk, including but not limited to, sub-accounts, investor's account in CDC and movement of securities-to/from these sub-accounts, third party confirmation electronically, etc.

CASH BALANCES

A Different set of Rules, Regulations, and Laws enacted to mitigate risk to protect cash balances of investors with stockbrokers including but not limited to segregation of client balances, a separate bank account with clear instructions to use word "**Clients**" along with record/breakdown of Clients' balances in the back offices, etc.

All this is, by and large, in line with the broader objective of the Securities Act, 2015, when it relates to **Protection of Investors**.

However, reading Rule 4.17 of PSX Rule book negates this broader objective, and rather than mitigating the risk of Client's balances in the custody of brokers, it actually promotes and provokes Client to keep their cash balances with the stockbrokers.

Under the said Rule 4.17.1(a), it makes it compulsory for every stockbroker to pass on the profit earned on Client's balances to the respective clients. This mandatory requirement to pass on the profit earned to clients is allowing an incentive to the Clients and therefore comes under "**promoting and provoking**" Clients to leave their cash balance with the stockbrokers. This is against the basic broader objective of the Securities Act, 2015.

Although this rule is silent as to what amount or percentage shall be passed on to Clients yet providing an incentive against the basic objective of a promulgated law is unlawful.

We also wish to draw attention that stockbrokers are not allowed to charge delay payments to its Clients.

Hence stockbrokers are under a double-edged sword where on the one hand they have to give profit on the cash balance of Clients and on the other hand they cannot charge financial impact on delayed payments by the same Clients.

We all live in the real world, wherein the entire service sector is allowed to charge financial impact on delayed payments yet no return is given on advance payments. Stockbrokers, being financial intermediaries, are suffering badly due to this rule that does not allow them to charge financial impact on delayed payments, and also they have to share the profit earned on the Client balances.

All over the world, in order to provide protection, service providers are given this right to charge financial impact on delayed payments to its Clients. All service providers be it electricity, gas, telephone, water, internet service providers, education providers, etc. are allowed, under the current laws of Pakistan, to charge a penalty on non-payment by the due date and stockbrokers should not be an exception.



While we do not wish to open debate on the apprehensions of Apex Regulator that same can be misused by stockbrokers and might promote undocumented in-house financing, but we request that at least it should be allowed on **first debit appearing in the Clients ledger**. This can be checked by auditors as it's nomenclature in profit and loss account would be **income from delayed payments/penalty income** and auditors can randomly or through the substantive test can verify that whether it was imposed on the first debit or it has been misused by the relevant stockbroker.

You will also acknowledge that the broker's commission covers only 6 days of delay payment. If we work out brokerage commission on 1m shares @ Rs. 100 each then it will be Rs. 150,000 and even if the Client is giving a 35% cash margin than borrowing cost of Rs. 65m @ 14% p.a. would be around Rs. 25,000 per day. The brokerage commission earned will, therefore, covers only 6 days of delayed payment.

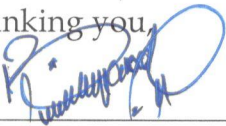
Being financial intermediaries we cannot be standalone in isolation with the present value concept.

We understand that allowing delayed payments is subject to approval by Apex Regulator but alteration in Rule 4.17.1(a) is in-house.

We request you that change the above Rule as PSX being a front-line Regulator is not expected to make Rules against the enacted law.

Lastly, we would like to request an opportunity to meet you in person to discuss the above.

Thanking you,



BILAL FAROOQ ZARDI

Secretary General

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