



# PAKISTAN STOCK BROKERS' ASSOCIATION

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

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August 26, 2020

**MR. FARRUKH H. KHAN**  
Managing Director  
Pakistan Stock Exchange Ltd  
Karachi.

Subject: **PROPOSALS FOR DEVELOPMENT OF CAPITAL MARKET**

Dear Mr. Khan,

This is with reference to the ultimate and broader objective of the Government of Pakistan for the Capital Market to be developed on the lines of International Best Practices. Being a stakeholder, we are pleased to submit our proposals/suggestions in the matter, for your kind perusal and necessary actions to be taken.

Please do not hesitate to contact the undersigned should you so desire to discuss the same in person.

Regards,

**BILAL FAROOQ ZARDI**

Secretary General

Cell# 0300- 266 2516



“Annexure A”

## PROPOSALS FOR THE MANAGEMENT OF PAKISTAN STOCK EXCHANGE

1. **Restoration of Autonomy of PSX:** Though, PSX is a listed company itself, yet has been directly controlled by the severity of regulations by the Apex Regulator (SECP). Despite control on the Board of Directors (BOD), the regulator has kept the power of issuing a binding directive. In addition to that, the regulator has kept for itself concurrent jurisdiction over the Stock Exchange.
2. **Securities Brokers (Licensing and Operations) Regulations, 2016:** In the presence of these regulations, the objective of market development can never be achieved. These need to be re-examined and perhaps re-written, in consultation with the regulated persons/stakeholders. Duplication of work & reporting with all the three SROs is a major cause of concern.
3. **AML/CFT Compliance:** AML/CFT is a continuous and never-ending exercise. Its enforcement through levy of heavy penalties is causing financial loss and mental ailment to the brokers. It may please be stopped. AML thematic review is breaking the back of the small and medium brokers. The understanding of the inspecting staff of the JIT committee is different from the members' compliance department. Therefore, it is recommended to make a working group comprising officials from the Association, the SECP and the PSX with the JIT supervisors. The requirements of JIT should be practical & logical. Some sort of test paper, to comply, may be issued so that the members' compliance department may have peace of mind. At least the member knows the direction in which to proceed.
4. **Fortnightly and Financial Reporting System on one portal for all:** Fortnightly and Financial Reporting System, all financial and other reporting shall be through a data portal which can be accessed by SECP, PSX, CDC, NCCPL, Banks, etc. enabling the members to concentrate on business activities rather than reporting regulatory requirements.
5. **Electronic Intimation of Changes in Commission Structure and Account Opening Forms may be allowed:** Under the regulation 4.25 of PSX Rule Book, any change in broker/client relationship for example new enhanced rate of commission has to be approved in writing by the respective client. Further, any change in the account opening form also requires the form to be signed by the client. These requirements may please be allowed through electronic intimation.
6. **Bond/Debt Instruments:** Bond/Debt instruments secondary market trading on PSX should be facilitated on an urgent basis and to make it user-friendly & cost-effective, the requirement of separate BATS counter should be waived. Let the DEBT market window be available to all for view only.



7. **Documentation for Opening an Account:** When a new client comes to a member, having gone through KYC at the stage of opening a Bank account along with biometric verification and being a tax-payer citizen of Pakistan, is bombarded with a 20 page's form along with the long list of documents to be provided including proof of mailing address and source of funds. We feel that only FBR or any other government agency should have the right to ask for a source of funds (most clients are hesitant to provide documents related to income and wealth) and document requirements should only be limited to Zakat declaration and attested copy of CNIC for the members. Condition of biometric verification should also be removed at the end of members.
- " The forms should be reduced to just 4 pages (not just give an impression of being concise but should be limited to important information only). The client should only be required to fill account opening form once when he is entering the capital market either with a member when opening a trading account or when opening an investor account with CDC, and the information provided should be shared through a centralized server with all concerned parties (CDC, NCCPL, PSX and SECP).
8. **Electronic Account Opening Form:** In addition to the above, this would be a game-changer if the concept of the Electronic Account Opening Form is introduced. There is an urgent need to enable technology and regulations wise the ability to open accounts digitally.
9. **Mandatory "CDC Investor Account" - A Safety Valve for the Brokers / Market:** Many times we have requested SECP that keeping a "CDC Investor Account" in addition to "CDC Sub-Account" may be made mandatory for the customers. SECP, so far, has not given a serious thought to our demand.
10. **Consolidated Mechanism for Multiple Audits:** A long outstanding demand of the members to introduce a consolidated mechanism for system audit be given due consideration and amendments proposed in this regard may please be approved following the consent of the Exchange for it to be practiced as soon as practically possible.
- " Name the audits being performed in one year in the stock brokerage business
- Yearly Audit by external auditors;
  - Half-yearly review by external auditors;
  - Net Capital Balance (bi-annually);
  - CDC - Asset under Custody now optional to be part of the audit report;
  - System Audit (selection through ballot, once in 2 years);
  - Client Asset Segregation- annually;
  - Liquid Capital (bi-annually);
  - JIT - JIT committee is overburdened with AML reviews after the FATF requirement;
  - Unaudited NCB and LC monthly in NCHS, and now have to input in NCCPL; and
  - Unaudited CASS fortnightly.



11. **Offices/Rooms in PSX Premises:** A negative list may please be issued in respect of sale/rent the offices in PSX premises.
12. **Defaults by Listed Companies:** The Exchange is requested to further strengthen its role to stop the defaults being practiced by listed companies. One of the examples is HASCOL.
13. **In-House Financing:** The restoration of In-house Financing in light of the reporting requirement will also have a positive impact on the volumes.
14. **Abolishment of Liquid Capital Balance (LCB):** Latter was introduced on the pretext that Net Capital Balance (NCB) will be abolished, but regrettably nothing has been done to date. Furthermore, the formula to determine LCB/NCB requires re-thinking. E.g. in the financial statements of any company when that company borrows funds on the basis of the pledge of shares, both the borrowing and shares (being assets) are shown separately in its balance sheet. Whereas, in NCB, the collateral placed with exchange against Client's Assets under Brokers Custody is required to be deducted from Brokers Assets for the computation of NCB. Remember, risk and rewards do not transfer with the placement of this collateral. Hence, this requirement should be abolished.

*Handwritten signature in blue ink, possibly 'M. Y. Khan', with a blue circular scribble below it.*





"Annexure B"

AMENDMENTS TO BE PROPOSED IN PSX REGULATIONS

REGULATION	DESCRIPTION	PROPOSED	RATIONALE
2.4(viii)	<b>Base Minimum Capital (BMC)</b> means the collateral deposited and/or maintained by the Securities Broker with the Exchange for its eligibility to trade through the Exchange Trading Systems to be calculated/prescribed as per Schedule-I annexed to chapter 19 of PSX Regulations;	Delete	<p>If BMC is to be deposited for eligibility to trade then what is Trading Right Entitlement Certificate (TREC)?</p> <p>In fact, TREC is eligibility to trade.</p> <p>In order to distinguish BMC from Client Asset Under Custody (CAUC).</p>
19.2	<b>BMC:</b> Every Securities Broker desiring to trade in any Market shall be required to maintain a Base Minimum Capital of the amount and in the form as calculated/prescribed in Schedule-1 annexed to this Chapter.	Delete	<p>Since it is for <b>eligibility to trade</b> and keeping in view that all bids &amp; offers are subject to pre and post-trade margins therefore it is just an additional unnecessary requirement.</p> <p>Nowhere else's in the world, except India, this is being practiced. In India, the amount is Rs. 1m only and it is subject to segment-wise.</p> <p>It is a hurdle for new entries, therefore its deletion will be considered under ease of doing business.</p>
Schedule 1	<b>BASE MINIMUM CAPITAL TO BE MAINTAINED BY A SECURITIES BROKER</b>	Collateral against Client's Assets under Custody (CAUC) of Brokers	Eligibility to trade mixed up with collateral against CAUC has been corrected.



REGULATION	DESCRIPTION	PROPOSED	RATIONALE
Schedule 1	Every Securities Broker shall maintain Base Minimum Capital ('BMC') as per the following slabs with the Exchange which shall be determined based on the Assets Under Custody (AUC) which is same as the Custody Position held under its Participant Account with CDC:	Every Securities Broker shall maintain Client's Assets Under its Custody (CAUC) as per the following slabs with the Exchange which shall be determined based on the Custody Position held under its Participant Account with CDC:	<p>Eligibility to trade mixed up with collateral for CAUC has been corrected.</p> <p>A new regulation added which takes care of CAUC.</p> <p>This shall only be applicable to those brokers which have CAUC in line with "Collateral against risk assets".</p> <p>Replacement of progressive percentage with slabs will provide more equitable and risk gearing.</p> <p>Further, PSX should have its own definition of AUC instead of relying on the definition of CDC Regulations.</p>
4.17.1(a)	<p>The Securities Brokers shall ensure that the assets belonging to their clients are kept separated from the assets of the Securities Broker. For this purpose, the Securities Broker:</p> <p>(a) shall maintain separate bank account(s), with word "clients" in the title, which will include all funds of their clients deposited with the Securities Broker for purposes of trading or subscription of securities offered through IPO, along with record/breakdown of client's</p> <p>---</p>		<p>To bring it in line with the existing Securities Act, 2015.</p> <p>Tax Heaven for non-filers.</p> <p>For the protection of investors latter should be discouraged to keep funds with stockbrokers.</p> <p>Non-filers are enjoying it as tax rate on non-filers is double on bank deposits. Stock Brokers do not deduct tax on this sharing.</p>



REGULATION	DESCRIPTION	PROPOSED	RATIONALE
	<p>----- balances in its back office.</p> <p>The Securities Broker may keep clients' unutilized funds in a profit-bearing bank account and in such case, shall pass on the profit earned on these funds to the clients in proportion to the client's unutilized balance unless specified otherwise in writing by the client; Provided that the rate of profit to be passed on to the clients should not be more than the profit rate offered by the banks and the Broker shall not solicit money from its customers or public in general or make it part of its marketing material by offering return on unutilized funds. A Broker found involved in any such activity shall be subject to disciplinary actions. Provided further that the Broker shall not make an application for subscription of securities offered through IPO on behalf of its clients unless the client has paid subscription money or the client has sufficient credit balance with the Broker. Provided further that the Broker shall comply with the procedures prescribed by the Exchange and/or CDC in respect of the subscription of securities by the broker on behalf of their client through IPO including E-IPO.</p>	<p>The bold part of the description is to be deleted.</p>	<p><b>Protection of Investors</b> is amongst the main objective of issuance of the Securities Act, 2015.</p> <p>This Regulation negates the 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.</p> <p>Under the said Regulation, 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 <b>"promoting and provoking"</b> Clients to leave their cash balance with the stockbrokers. This is against the basic broader objective of the Securities Act, 2015.</p> <p>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.</p>





REGULATION	DESCRIPTION	PROPOSED	RATIONALE
4.17.5	The Securities Broker within forty-five (45) days of the close of its financial year shall submit an annual "Clients' Assets Segregation Statement", duly verified by its statutory auditor.	The Securities Broker within one hundred and twenty (120) days of the close of its financial year shall submit or disclose its annual "Clients' Assets Segregation Statement", in its annual audited financial statements.	To bring it in line with the existing Companies Act, 2017. Keeping in view the requirements of the Companies Act, 2017, for a brokerage house, being listed company, this verification by auditors may bring up issues pertaining to price-sensitive information, therefore, the period of 45 days be replaced with 120 days.
19.3(b)(v)	If the Security is listed on Futures Trading in Provisionally Listed Companies Market then the circuit breaker of Rs.5 or 50% whichever is higher, shall be applicable on the offer price during the first trading day in Futures Trading in Provisionally Listed Companies Markets.	Delete	Make it in line with the normal practice of 7.5% or Re. 1.00 whichever is higher as mentioned in Regulation 19.3(a)
4.11	IN CASE OF ACTIVATION OR REACTIVATION OF A TREC CERTIFICATE HOLDER AS SECURITIES BROKER:	Active Stock Broker, may for whatever reasons, apply to PSX for a dormant status, subject to conditions mentioned in Regulation 4.9	To bring it in line with the objective of the Demutualization Act, 2012. Presently, at PSX, there is no such option available for the TREC Holders, and the only option available is to surrender the TREC. This is, indeed, not a business-friendly.  TREC, being a Right, has certain value attached therewith. These regulations recognize it at a notional value of Rs. 2.5m (Schedule 1 under Regulation 19.2). Therefore, it should be considered as a separate asset of every stock brokerage Company. Since, the Demutualization Act,





			<p>2012 is silent on the concept of life after anaesthesia, particularly temporary closure of stock brokerage business after being in operations, therefore, the concept of Dormant TREC be allowed.</p> <p>Though, we have a regulation on reactivation but nothing has been incorporated to give benefit to active TREC holders who, for any reason, wish to discontinue business, temporarily, for a certain period.</p> <p>Period may be defined which may not be more than consecutive three to five years.</p> <p>A broker whose TREC is treated as a separate asset and is dormant, may at any time thereafter apply to the Exchange for reactivation by submitting such information including the financial condition of the broker as the Exchange may require. Furthermore, a dormant brokerage house must be allowed to trade with another broker of the Exchange till the time, the TREC is under dormant status.</p> <p>It will elevate Stock Brokers both in terms of value for their assets and business operations.</p> <p>Our request, as above, will not only save Stock Brokers from force closure of their businesses but would also benefit Exchange in arresting the surrendering ratio.</p>
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REGULATION	DESCRIPTION	PROPOSED	RATIONALE
NEW		<p><b>Delayed Payments</b></p> <p>The Securities Broker may charge a penalty on delayed payments by the Clients, subject to the condition that it can only be charged on the first debit appearing in Client's ledger. Any subsequent debit, other than the penalty on first debit shall be construed as financing and shall be subject to disciplinary action.</p>	<p>Stockbrokers, being financial intermediaries, are suffering badly as regulations do not allow them to charge financial impact/penalty on delayed payments on Client balances.</p> <p>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. even NCCPL 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.</p> <p>This can be checked by auditors as it's nomenclature in profit and loss account would be <b><u>income from delayed payments/penalty income</u></b> 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. Broker's commission covers only 6 days of delay payment. Brokerage commission on 1m shares @ Rs. 100 each works out to be Rs. 150,000 and with 35% cash margin the borrowing cost of Rs. 65mn 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.</p>

**THANK YOU**

