PAKISTAN STOCK BROKERS ASSOCIATION

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

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Bilal Farooq Zardi
Secretary General

Ref: PSBA/S0122-01
January 4, 2022

MR. AAMIR KHAN
Chairman
Securities and Exchange Commission of Pakistan
Islamabad.

Subject: **REDUCTION IN THE CAPACITY TO CONDUCT BUSINESS (LIQUID CAPITAL BALANCE)**

Dear Sir,

We have been approached by our members to raise their serious concern over the reduction in their capacity to conduct business by virtue of replacing Net Capital Balance (NCB) with Liquid Capital Balance (LCB).

We are well aware of the fact that the amount of LCB, due to its nomenclature, will always be lower than the NCB and we estimate that it is generally lower by 30% to 40% of the amount calculated under NCB.

Our members' capacity to conduct business has been severely obstructed by this double edge sword. On the one hand, available balance under LCB will always be lower than NCB and on the other hand, the factor to compute capital adequacy has also been slashed from 25 times to 15 times. Accordingly, with this, both end sword, our members' capacity has been substantially reduced by approximately 75% of the previously available capacity.

You are well aware that based on Rs. 300m NCB which translates into Rs. 200 LCB our members were entitled to following capital adequacy:
1) Previously on Rs. 300m NCB it was Rs. 7.5b; and
2) Currently on Rs. 200m is it Rs. 3b.

This clearly exhibits reduction in capacity by Rs. 4.5bYou will recall that introduction of NCB was much prior to introducing pre and post-trade, value at risk (VAR) based margins.

In a T+2 environment, where settlement is on the 3rd day the maximum amount that could be at risk will be for 02 to 03 days of lower circuit breakers @ 7.50%. When we compute it for a maximum of 03 days then the maximum amount of risk will be 20.6234% as against the margins collected on VAR based when computed at market rates are morethan 25%.

Surprisingly, after the implementation of pre and post-trade VAR-based margins, the risk covered is much more than the required 20.6234%. This expels the otherwise available liquidity from the market.

We all acknowledge that stock markets are always liquidity starved and with unnecessary retention of otherwise available liquidity in whatsoever form such as LCB, BMC, concentration margins, and more than 21% for settlement purposes the capacity to conduct business will be severely affected.

You will also acknowledge that audited LCB reflects the position on a specific date, the quarter ended, it does not give any kind of assurance or cushion for any other future date, for example, positive LCB as of September 30 cannot give any assurance that the liquidity will also be available on any other future date before next quarter, December 31. This makes the requirement redundant as it cannot be used. Furthermore, we must also realize that how just Rs.10 million, the minimum requirement for LCB, cover the risk of broker default. The magnitude of trade execution does not reconcile with this small amount. Though the amount is small individually but turns out to be huge collectively, for providing liquidity in the stock market.

Being an Apex Regulator, you are therefore requested to remove anomalies and take corrective measures for ease of business.

Best Regards,

Cc:

Mr. Muhammad Lukman - CEO - NCCPL
Mr. Ajeet Kumar - CRO- PSX
Mr. Oneeb Ahmed - Assistant Director - SECP

SECP

Securities and Exchange Commission of Pakistan
Securities Market Division
Policy, Regulation and Development Department

No. SMD/SE/2(260)/2015/1 January 06, 2022

Mr. Bilal Farooq Zardi
Secretary General
Pakistan Stock Brokers Association
Mezzanine Floor, Trading Hall, Stock Exchange Building
Off I.I. Chundrigar Road, Karachi.

Subject: Reduction in the capacity to conduct business (Liquid Capital Balance)

Dear Sir,

This is with reference to your letter dated January 04, 2022 concerning the subject matter.

You will appreciate that the international best practice of maintaining Liquid Capital (LC), instead of Net Capital Balance (NCB), have been implemented after thorough public consultation and marathon deliberations for over last three years with all stakeholders including the Pakistan Stock Brokers Association (PSBA). LC is a more sophisticated and elaborative manner of computing the current financial adequacy of securities brokers as it covers in detail the accounting treatment of each component of financial statements, which also makes it more practicable.

We understand that the concerns raised by the securities brokers regarding reduction in their capacity of doing business have already been proactively addressed while implementing the LC regime, wherein, the exposure limits have been retained at 25 times for the ready market and in fact further enhanced to 7.5 times for the futures market and leveraged market. Further, PSBA may share the computation process and factors which in its view may lead to reduced amount of LC in comparison with NCB.

As far as the generic figures provided in your letter are concerned, it is requested to provide us with a detailed working on how the business capacity has been assessed to have relatively reduced in conjunction with the amount arrived at for calculation of capital adequacy of the securities brokers so that necessary review may be initiated, if considered essential.

With respect to the contention put forward regarding the information provided through LC, it may please be noted that as per regulation 6(1)&(5) of the Regulations, securities brokers are required to fulfill and ensure ongoing compliance with minimum financial resource requirement and inform the securities exchange and the Commission immediately in case they are failing to meet the prescribed LC requirement. Moreover, monthly unaudited figures of LC are also submitted by securities brokers to National Clearing Company of Pakistan Limited for risk management purposes. Furthermore, it is pertinent to mention that under the recently introduced Professional Clearing Member(PCM) framework, the Trading Only Broker are exempted from maintaining LC upon complete transfer of their custody and clearing functions to PCM.

SECP

Securities and Exchange Commission of Pakistan
Securities Market Division
Policy, Regulation and Development Department

We at the Securities and Exchange Commission of Pakistan (SECP) are particularly focused at facilitating brokers industry to encourage more investments in stock market. To this end, the SECP has already relaxed certain regulatory requirements to do away with stringent risk management requirements, inter alia, rationalization of concentration margins, removal of 15% additional margin of VaR in category B stocks of DFC market, collection of 100% exposure margin in the form of government securities or in cash, distribution of up to 50% MtM profits in DFC market etc.

We hope that the above explanation will address your concerns.

Yours truly,

(Mateenullah Khan)
Additional Director

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