



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

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Stock Market Task Force Presents Report to SEC

The task force, constituted by the Securities and Exchange Commission of Pakistan (SEC) to assess and analyse the stock market situation in March 2005, presented its report during July. Mr. Justice (Retd.) Saleem Akhtar, former Federal Tax Ombudsman and Chairman of the task force, presented the report to Chairman SEC, Dr. Tariq Hassan. The task force included Dr. Zubair Khan, Mr. Shahid Kardar and Mr. Sultan Allana as members and Mr. Aadil Naeem Khan as secretary.

The task force was required to identify causes of situation arising in the Karachi, Lahore and Islamabad Stock Exchanges during 1 January to 31 March 2005, analyze the role of various market participants and investigate

allegation of market manipulation. It was also required to examine the role of various stakeholders including the frontline and apex regulators, financial institutions, and brokers at the three bourses and to suggest operational and regulatory reforms.

The task force finalized its report after meeting all the stakeholders including brokers, representatives of financial institutions, management of the three stock exchanges, the SEC, capital market experts and investors. Mr. Justice (Retd) Saleem Akhtar said that the task force had comprehensive terms of reference and despite time constraint, it had looked at all the issues in depth.

Record Number of Companies Registered with SEC in July

Registration of new companies with the SEC reached a record number of 906 during the month of July 2005. This was almost a four-times increase over 239 new companies registered in the same month during last year. The unprecedented boom in incorporation is due to the steps taken by the SEC to engender investor confidence and facilitate corporatization.

Of the 906 companies, 901 were limited by shares, comprising three public unlisted companies, 859 private companies and thirty-nine single member companies. In addition, one foreign company and four not-for-profit associations were also registered.

The SEC's Company Registration Office (CRO) at Karachi registered the highest number of 302 companies, a record registration during one month by any CRO. Lahore and Islamabad CROs followed with registering 224 and 190 companies respectively, while CROs at Peshawar, Quetta, Multan, Faisalabad and Sukkur registered eighty-five, forty-two, forty-one, twenty-one and one company each.

During the month, 582 Haj and Umra operators were registered as companies. A total of fifty five companies were registered in trading sector, twenty nine in communications and twenty eight in textile sector.

Bilateral Dialogue with Norwegian and Swedish Diplomats

The Norwegian Ambassador to Pakistan, Mr. Janis Bjorn Kanavin and Mr. Lennart Holst, Commercial Counsellor at the Swedish Embassy visited the SEC head office and met its Chairman Dr. Tariq Hassan.

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Badla is Not Back By Dr. Tariq Hassan

The article was written by the Chairman SEC, Dr. Tariq Hassan and published in daily the News on July 19, 2005

I am grateful to The News for its backhanded support to the phase-out of badla financing in its editorial "Badla is back" (July 15) – a provocative and totally misleading title which suggests that badla financing had been eliminated and has now been reintroduced. This is simply not true. Even the inference that the process has been rolled back is false. Nonetheless, the editorial makes a very important point in favour of the phase-out of badla financing and, even though it is ostensibly critical of the role of the regulator, I appreciate the spirit behind it.

I reinforce the editorial's underlying message that badla financing should go. There is no turning back. The process of phase-out of badla financing has only been suspended temporarily on account of the current liquidity concerns and to allow banks more time to develop margin financing at the retail level to accommodate small brokers and investors. The replacement of badla funds with alternative modes of financing, including margin financing, has not been stopped. Adjustment to the alternative modes of financing are expected to continue. The regulator remains fully committed to its declared objective and is seeking to achieve this with principled pragmatism.

The regulator does not operate in a vacuum and cannot work in isolation. It needs the support of both the government and the judiciary to implement and enforce the laws it administers. Furthermore, while undertaking reforms, the Regulator cannot ignore economic realities and needs the constant support of the public and the media. It is faced with additional difficulties in carrying out capital market reforms in a running market.

Despite all the odds, the Securities and Exchange Commission of Pakistan (SECP) has managed to carry out important administrative and operational reforms in the capital markets which have considerably improved the transparency, governance, and risk management system at the Stock Exchanges. The SECP now seeks to make fundamental structural and institutional changes without which the earlier reforms cannot be sustained or the primary regulatory objective of protecting investors met. The most important ongoing reforms include the phase-out of badla financing, demutualization of the exchanges, the elimination of group accounts and the introduction of universal client identification.

It was necessary to eliminate group accounts in April, despite the attendant difficulties, in order to do away with the benami system of trading that made enforcement difficult for the regulators. The introduction of universal client identification system is also needed to enhance the

regulator's enforcement capability. The demutualisation is imperative to modernise the Stock Exchanges. The phase-out of badla financing is essential to eliminate manipulation and reduce market volatility. The timed phase-out has been suspended, but the process has not been stopped and there is no back-tracking. Badla financing will eventually be replaced by alternative modes of financing.

This is a mechanism of post trade financing of shares unique to Pakistan, that allows weak holders and speculators to buy shares and simultaneously enter into a sell-buy transaction to finance the purchase of shares. Badla financing has been repeatedly identified as the root cause of all major capital market crises in Pakistan since it allows for over-speculation and manipulation by market players. The systemic risk posed by badla financing is particularly detrimental to investor interests and market integrity.

Mindful of this and duty-bound to protect the interests of investors and ensure effective risk management, the SECP initiated the phase-out of badla financing in October 2003, after extensive consultation with key stakeholders, including stock exchanges, brokers, the State Bank of Pakistan, and the government through the Ministry of Finance. As a result of this consultative approach, the time-bound action plan for the gradual phase out of badla financing was developed after discussions with the Stock Exchanges.

The Stock Exchanges have not kept their bargain, nor have the banks been able to provide alternative financing in the desired time frame particularly to small investors and brokers. This situation, compounded by the current liquidity concerns, left the SECP no choice but to suspend the time-bound process for the phase-out of badla financing.

The SECP however remains firm in its resolve to end badla financing. It has come a long way in this process and needs to be supported rather than excoriated. The editorial criticises the SECP's ability without assessing the good intentions and determination with which it is pursuing its goals!

The SECP could scoff at the naivety of the editorial in assuming a hurdle-less race to the finish line of this major reform or question the result it seeks to achieve, but chooses to look at the positive aspect of the editorial's implicit support of its reform effort. The regulator has a commitment to fulfil. Making an exit from the SECP, as suggested by the editorial, is an easy option but would not only be an abdication of responsibility but also undermine the process of reform.

Useful Tools Added to SEC's Website

To facilitate registration of companies and to promote compliance with legal requirements, the SEC introduced an "Incorporation Fee Calculator" on its website. This calculator would assist in computation of incorporation fee with respect to any capital structure as per the rates prescribed under the law. Moreover, corporate entities requiring enhancement in authorized capital can also calculate the fee payable on such enhancement.

A comprehensive "Schedule for filing of returns and documents with the SEC" has also been added to the website, highlighting the statutory responsibilities of corporate entities under the Companies Ordinance, 1984 and the rules made thereunder. The Schedule catalogues the filing requirements of companies, including mutual funds and modarabas. It covers information pertaining to submission of each form/return e.g., the events that lead to the filing of a return, due filing time and fee etc. Further, to keep the corporate sector informed regarding the rates of various fees to be paid to the registrar and the SEC for corporate activities, a "Schedule of Fee" has been placed on the website to facilitate computation of certain pecuniary charges.

Bilateral Dialogue with Norwegian and Swedish Diplomats

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The two diplomats were apprised of the reforms undertaken by the SEC over the past few years and the developments in the corporate sector, capital market and non-banking financial sector. They were also informed about the SEC's active participation in international standard setting bodies and the mutual cooperation agreements, both bilateral and multilateral, with various jurisdictions.

The delegates expressed particular interest in SEC's agenda on corporate governance and corporate social responsibility and shared experiences in their respective jurisdictions.

Draft Corporate Scorecard Prepared

The SEC developed a corporate scorecard to assist local and international institutional investors in evaluating the performance of companies in specified areas against targeted benchmarks.

The draft scorecard has been prepared in consultation with certain local institutional investors. It covers the financial outlook, internal business outlook, customer perspective, innovation and learning perspective, and corporate governance perspective of a company. The financial health of the company is assessed primarily by looking at its past financial performance. The other four perspectives are the indicators of future performance and growth. The scorecard is being introduced in line with SEC's vision for the development of corporate sector in Pakistan. Being the regulator of an emerging market, the SEC's regulatory philosophy is based on the principle of developmental regulation, whereby its role is not just limited to that of a regulator but is also that of a facilitator.

SEC to Enhance Presence in Balochistan

The Chairman SEC, Dr. Tariq Hassan, in a detailed visit to Balochistan, met senior government officials and discussed with them the possibilities to increase corporatization in the province. He told them that the SEC would enhance its strength and presence in Balochistan to facilitate and promote corporate sector.

In his separate meetings with the Balochistan Revenue Minister, Mr. Mir Muhammad Asim Kurd Gallo and Provincial Chief Secretary, Mr. K. B. Rind, Dr. Hassan said that SEC would do more to promote corporate culture in the province. He mentioned that SEC has evolved an expeditious corporatisation process to bring small and big businesses into the corporate net. Dr. Hassan also visited the Balochistan Women's University and IT University Balochistan. He discussed with the vice chancellors of the universities the scope for creating education opportunities in various fields relating to corporate sector and capital market.

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